**Before the**
**UNITED STATES COPYRIGHT ROYALTY JUDGES**
**Washington, D.C.**

| In the Matter of: | Docket No. 2009-1<br>CRB Webcasting III |
|---|---|
| Digital Performance Right in Sound Recordings and Ephemeral Recordings | |



# WRITTEN REBUTTAL STATEMENT OF SOUNDEXCHANGE, INC.

**Public Version**

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**June 7, 2010**

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# INTRODUCTORY MEMORANDUM TO THE WRITTEN REBUTTAL CASE OF SOUNDEXCHANGE, INC.

SoundExchange, Inc. ("SoundExchange"), through its undersigned counsel, respectfully submits this Introductory Memorandum to its written rebuttal case in accordance with 37 C.F.R. § 351.4. This Memorandum describes the contents of SoundExchange's written rebuttal case and briefly summarizes the testimony of its witnesses.

## CONTENTS OF SOUNDEXCHANGE'S WRITTEN REBUTTAL CASE

SoundExchange's written rebuttal case contains: (A) this Introductory Memorandum; (B) SoundExchange's Revised Proposed Rates and Terms, including proposed regulatory language; (C) the written rebuttal testimony of Janusz Ordover; (D) the written rebuttal testimony of Kyle Funn; (E) SoundExchange Rebuttal Exhibit 1 (a template Statement of Account form); (F) SoundExchange Rebuttal Exhibit 2 (Restricted) (a Live365 Statement of Account form); and (G) a certificate of service.

Pursuant to 37 C.F.R. § 350.4(a), § 351.4(a), and the Court's Order of June 24, 2009, SoundExchange is filing an original, five copies, and an electronic copy of the materials in its written rebuttal case.

SoundExchange Rebuttal Exhibit 2 is a Live365 Statement of Account, which is confidential under 37 C.F.R. § 380.5. Pursuant to § 380.5(d)(4), SoundExchange has marked this exhibit as Restricted, and is filing a motion to designate the exhibit as Restricted.

## SUMMARY OF SOUNDEXCHANGE'S WRITTEN REBUTTAL CASE

### A. Revised Proposed Rates and Terms

SoundExchange's rate proposal is in large part unchanged. The per performance royalty rates set forth in SoundExchange's Revised Proposed Rates and Terms are the same as proposed in SoundExchange's original rate proposal. SoundExchange's proposal has been revised in the following ways: (1) to reflect developments with respect to the NAB and CBI settlements previously proposed; (2) to reflect the stipulation that SoundExchange and Live365 submitted with respect to ephemeral recordings and the minimum fee for commercial webcasters; and (3) to propose a term clarifying details related to the submission of statements of account. In addition, SoundExchange is submitting proposed regulations that implement SoundExchange's rate proposal. The proposed regulations show changes from the current regulations in redlined format.

### B. Witness Testimony

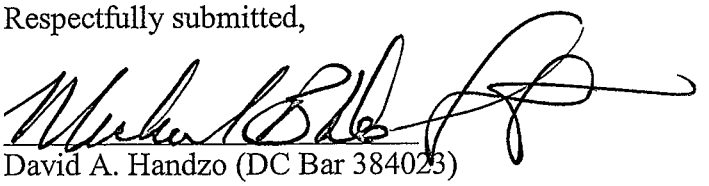
SoundExchange is submitting the written testimony of two witnesses, one of whom is an expert witness (Ordover) and one of whom is a fact witness (Funn).

Janusz Ordover, Ph.D., is Professor of Economics and former Director of the Masters in Economics Program at New York University. He previously served as Deputy Assistant Attorney General for Economics at the Antitrust Division of the United States Department of Justice. His areas of specialization include industrial organization economics, particularly antitrust and regulation economics. Dr. Ordover's testimony rebuts the testimony of Live365's

expert witness, Mark Fratrik. First, Ordover testifies that Dr. Fratrik's methodology for developing a recommended rate structure is severely flawed -- it is premised on the false assertion that Live365 is a typical webcaster; and it assumes that a webcaster is entitled to a 20% operating margin, which lacks a sound economic basis and is inconsistent with the willing buyer/willing seller standard. Second, Ordover responds to Fratrik's claim that the Judges should not consider the SoundExchange-NAB agreement without substantial adjustment. Ordover explains why Fratrik's criticisms of the NAB agreement are unfounded. He concludes that the rates contained in the NAB agreement are probative evidence for setting rates under the willing buyer/willing seller standard.

Kyle Funn is Manager, Licensing and Enforcement, at SoundExchange. His job responsibilities include monitoring licensees' compliance with statutory and regulatory requirements. His testimony rebuts Live365's claim that it is entitled to a so-called "aggregator discount" by explaining that Live365's conduct has imposed burdens on and created additional work for SoundExchange.

Respectfully submitted,



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B

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| In the Matter of:<br><br>Digital Performance Right in Sound Recordings and Ephemeral Recordings | Docket No. 2009-1<br>CRB Webcasting III |

**REVISED PROPOSED RATES AND TERMS OF SOUNDEXCHANGE, INC.**

Pursuant to Section 351.4(b)(3) of the Copyright Royalty Judges' Rules and Procedures, 37 C.F.R. § 351.4(b)(3), SoundExchange, Inc. ("SoundExchange") proposes the rates and terms set forth herein for eligible nonsubscription transmissions and transmissions made by a new subscription service other than a service as defined in 37 C.F.R. § 383.2(h) (collectively, "Webcast Transmissions"), together with the making of ephemeral recordings necessary to facilitate Webcast Transmissions, under the statutory licenses set forth in 17 U.S.C. § 112(e) and 114 during the period January 1, 2011 through December 31, 2015.

Pursuant to 37 C.F.R. § 351.4(b)(3), SoundExchange reserves the right to revise its proposed rates and terms at any time during the proceeding up to, and including, the filing of its proposed findings of fact and conclusions of law.

## I. Proposed Settlements

On June 1, 2009, SoundExchange and the National Association of Broadcasters ("NAB") submitted a Joint Motion to Adopt Partial Settlement requesting that the Copyright Royalty Judges adopt certain rates and terms for "Broadcast Retransmissions" and "Broadcaster Webcasts," as defined therein. On August 13, 2009, SoundExchange and College Broadcasters, Inc. ("CBI") submitted a Joint Motion to Adopt Partial Settlement requesting that the Copyright Royalty Judges adopt certain rates and terms for eligible nonsubscription transmissions made by

noncommercial educational webcasters over the internet, as more specifically provided therein. The Copyright Royalty Judges published both settlements for notice and comment pursuant to 17 U.S.C. § 801(b)(7)(A) and 37 C.F.R. § 351.2(b)(2) on April 1, 2010. 75 Fed. Reg. 16,377 (Apr. 1, 2010). SoundExchange requests that the Judges adopt these settlements as published, subject to correction of the transcription errors in the CBI settlement that SoundExchange noted in its Comment Concerning Proposed Settlements, filed April 22, 2010.

## II. Other Royalty Rates

For all Webcast Transmissions and related ephemeral recordings not covered by its proposed settlements with NAB and CBI, SoundExchange requests royalty rates as set forth below.

### A. Commercial Webcasters

#### 1. Minimum Fee

Pursuant to 17 U.S.C. §§ 112(e)(3) and (4) and 114(f)(2)(A) and (B), SoundExchange requests that all commercial webcasters (as defined in 37 C.F.R. § 380.2(d)) pay an annual, nonrefundable minimum fee consistent with the Stipulation of SoundExchange, Inc. and Live365, Inc. Regarding the Minimum Fee for Commercial Webcasters and the Royalty Payable for the Making of Ephemeral Recordings, filed May 14, 2010.

#### 2. Per Performance Rates

For Webcast Transmissions and related ephemeral recordings by commercial webcasters as defined in 37 C.F.R. § 380.2(d), in addition to the minimum fee, SoundExchange requests royalty rates as follows:

| Year | Rate Per Performance |
|---|---|
| 2011 | $0.0021 |
| 2012 | $0.0023 |
| 2013 | $0.0025 |
| 2014 | $0.0027 |
| 2015 | $0.0029 |

**B. Noncommercial Webcasters**

**1. Minimum Fee**

Pursuant to 17 U.S.C. §§ 112(e)(3) and (4) and 114(f)(2)(A) and (B), SoundExchange requests that all noncommercial webcasters (as defined in 37 C.F.R. § 380.2(h)) pay an annual, nonrefundable minimum fee of $500.00 for each calendar year or part of a calendar year of the license period during which they are licensees, for each individual channel and each individual station (including a side channel maintained by a broadcaster that is a licensee, if not covered by SoundExchange's proposed settlement with CBI). For each licensee, the annual minimum fee described in this paragraph shall constitute the minimum fees due under both 17 U.S.C. §§ 112(e)(4) and 114(f)(2)(B).

**2. Per Performance Rates**

For Webcast Transmissions and related ephemeral recordings by noncommercial webcasters as defined in 37 C.F.R. § 380.2(h), SoundExchange requests that if, in any month, a noncommercial webcaster makes total transmissions in excess of 159,140 aggregate tuning hours (as defined in 37 C.F.R. § 380.2(a)) on any individual channel or station, the noncommercial webcaster shall pay additional fees for the transmissions it makes on that channel or station in excess of 159,140 aggregate tuning hours at the following rates:

| Year | Rate Per Performance |
|---|---|
| 2011 | $0.0021 |
| 2012 | $0.0023 |
| 2013 | $0.0025 |
| 2014 | $0.0027 |
| 2015 | $0.0029 |

### C. Ephemeral Recordings

SoundExchange requests that the royalty payable under 17 U.S.C. § 112(e) be included within, and constitute 5% of, the payments described above, consistent with the Stipulation of SoundExchange, Inc. and Live365, Inc. Regarding the Minimum Fee for Commercial Webcasters and the Royalty Payable for the Making of Ephemeral Recordings, filed May 14, 2010.

## III. Terms

SoundExchange requests that the terms currently set forth in 37 C.F.R. Part 380 be continued, subject to the changes described herein and necessary technical and conforming changes.

### A. Server Log Retention

SoundExchange requests that the regulations expressly confirm that the records a licensee is required to retain pursuant to 37 C.F.R. § 380.4(h), and that are subject to audit under 37 C.F.R. § 380.6, include original server logs sufficient to substantiate rate calculation and reporting, which must be made available to the qualified auditor selected by the Collective in the event of an audit.

### B. Late Fees for Reports of Use

SoundExchange requests that reports of use be added to the list in 37 C.F.R. § 380.4(e) of items that, if provided late, would trigger liability for late fees (in the amount of 1.5% per month, or the highest lawful rate, whichever is lower).

### C. Identification of Licensees

SoundExchange requests that the regulations at 37 C.F.R. § 380.4(f) require statements of account to correspond to notices of use and reports of use by (1) identifying the licensee in exactly the way it is identified on the corresponding notice of use and report of use, and (2) covering the same scope of activity (e.g., the same channels or stations). In addition, SoundExchange requests that the regulations make clear that the "Licensee" is the entity identified on the notice of use, statement of account, and report of use, and that each "Licensee" must submit its own notices of use, statements of account, and reports of use. Finally, SoundExchange requests that the regulations require licensees to use an account number, that is assigned to them by SoundExchange, on their statements of account.

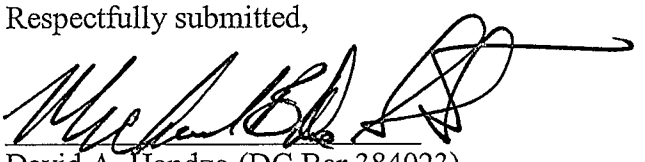
### D. Statements of Account

SoundExchange requests that 37 C.F.R. § 380.4(f) be modified to clarify that statements of account are to be provided on a form made available by SoundExchange, and to omit the requirement in 37 C.F.R. § 380.4(f)(3) that the signature on a statement of account be handwritten, in order to conform the regulations to broadly-applicable federal policy concerning electronic signatures. *See* Electronic Signatures in Global and National Commerce Act, Pub. L. No. 106-229, 114 Stat. 464 (2000) (codified at 15 U.S.C. § 7001 *et seq.*); *see also* Government Paperwork Elimination Act, Pub. L. No. 105-277, § 1704, 112 Stat. 2681 (codified in 44 U.S.C. § 3504 note).

## IV. Proposed Regulations

SoundExchange has attached proposed regulations implementing the foregoing requested rates and terms, including certain technical and conforming changes. The proposed regulations are marked to show changes from the regulations currently in 37 C.F.R. Part 380.

Respectfully submitted,

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June 7, 2010

**Attachment**
**Proposed Regulations**

# PART 380. RATES AND TERMS FOR CERTAIN ELIGIBLE NONSUBSCRIPTION TRANSMISSIONS, NEW SUBSCRIPTION SERVICES AND THE MAKING OF EPHEMERAL REPRODUCTIONS

**[Note: The subpart and section designations used herein were employed for convenience of reference. These proposed regulations assume adoption of the proposed rule published at 75 Fed. Reg. 16,377. Accordingly, they assume that 37 C.F.R. Subpart B will provide rates and terms for commercial Broadcasters, 37 C.F.R. Subpart C will provide rates and terms for Noncommercial Educational Webcasters, and a newly-designated 37 C.F.R. Subpart A will provide rates and terms for other users as determined in the litigated portion of this proceeding.]**

## SUBPART A—COMMERCIAL WEBCASTERS AND NONCOMMERCIAL WEBCASTERS

Sec.
380.1 General.
380.2 Definitions.
380.3 Royalty fees for the public performance of sound recordings and for ephemeral recordings.
380.4 Terms for making payment of royalty fees and statements of account.
380.5 Confidential information.
380.6 Verification of royalty payments.
380.7 Verification of royalty distributions.
380.8 Unclaimed funds.

Authority: 17 U.S.C. 112(e), 114(f), 804(b)(3).

### § 380.1 General.

(a) Scope. This ~~part 380~~**subpart** establishes rates and terms of royalty payments for the public performance of sound recordings in certain digital transmissions by Licensees **as set forth herein** in accordance with the provisions of 17 U.S.C. 114, and the making of Ephemeral Recordings by Licensees in accordance with the provisions of 17 U.S.C. 112(e), during the period January 1, ~~2006~~**2011**, through December 31, ~~2010~~**2015**. **[Note: The existing regulations variously refer to the statutory licenses as pursuant to section 112 or 112(e) and section 114 or 114(f). These proposed regulations conform subsequent provisions to this subsection, by consistently referring to sections 112(e) and 114.]**

(b) Legal compliance. Licensees relying upon the statutory licenses set forth in 17 U.S.C. 112**(e)** and 114 shall comply with the requirements of those sections, the rates and terms of this part, and any other applicable regulations.

(c) Relationship to voluntary agreements. Notwithstanding the royalty rates and terms established in this part, the rates and terms of any license agreements entered into by Copyright Owners and ~~digital audio services~~**Licensees** shall apply in lieu of the rates and terms of this part to transmission within the scope of such agreements.

**§ 380.2 Definitions.**

For purposes of this part, the following definitions shall apply:

(a) *Aggregate Tuning Hours* (ATH) means the total hours of programming that the Licensee has transmitted during the relevant period to all ~~Listeners~~**listeners** within the United States from all channels and stations that provide audio programming consisting, in whole or in part, of eligible nonsubscription transmissions or noninteractive digital audio transmissions as part of a new subscription service, less the actual running time of any sound recordings for which the Licensee has obtained direct licenses apart from 17 U.S.C. 114(d)(2) or which do not require a license under United States copyright law. By way of example, if a service transmitted one hour of programming to 10 simultaneous ~~Listeners~~**listeners**, the service's Aggregate Tuning Hours would equal 10. If 3 minutes of that hour consisted of transmission of a directly licensed recording, the service's Aggregate Tuning Hours would equal 9 hours and 30 minutes. As an additional example, if one ~~Listener~~**listener** listened to a service for 10 hours (and none of the recordings transmitted during that time was directly licensed), the service's Aggregate Tuning Hours would equal 10. **[Note: The term "listener" is not defined.]**

(b) *Broadcaster* is a type of ~~Commercial Webcaster or Noncommercial Webcaster~~**Licensee** that owns and operates a ~~terrestial~~**terrestrial** AM or FM radio station that is licensed by the Federal Communications Commission. **[Note: Relatively few Licensees will be Broadcasters as defined in this subsection if the proposed rule published at 75 Fed. Reg. 16,377, and the related changes to subsection (g) below, are adopted. However, SoundExchange suggests keeping this defined term for clarity in the few provisions in which it is used, because some broadcasters (e.g., noncommercial broadcasters not affiliated with schools) will remain subject to these rates and terms.]**

(c) *Collective* is the collection and distribution organization that is designated by the Copyright Royalty Judges. For the ~~2006-2010~~**2011-2015** license period, the Collective is SoundExchange, Inc.

(d) *Commercial Webcaster* is a Licensee, other than a Noncommercial Webcaster, that makes eligible digital audio transmissions.

(e) *Copyright Owners* are sound recording copyright owners who are entitled to royalty payments made under this part pursuant to the statutory licenses under 17 U.S.C. 112(e) and 114~~(f)~~.

(f) *Ephemeral Recording* is a phonorecord created for the purpose of facilitating a transmission of a public performance of a sound recording under a statutory license in accordance with 17 U.S.C. 114~~(f)~~, and subject to the limitations specified in 17 U.S.C.112(e).

(g) *Licensee* is a person that has obtained a statutory license under 17 U.S.C. 114, and the implementing regulations, to make eligible nonsubscription transmissions, or noninteractive digital audio transmissions as part of a new subscription service (as defined in 17 U.S.C. 114(j)(8)) **other than a Service as defined in § 383.2(h)**, or that has obtained a statutory license under 17 U.S.C. 112(e), and the implementing regulations, to make Ephemeral Recordings for use in facilitating such transmissions**, but that is not –**

**(1) a Broadcaster as defined in § 380.11; or**

**(2) a Noncommercial Educational Webcaster as defined in § 380.21**.

**[Note: The exclusion in the preamble of this subsection recognizes that these rates and terms do not apply to the new subscription services addressed in Part 383. The exclusions in paragraphs (1) and (2) assume adoption of the proposed rule published at 75 Fed. Reg. 16,377.]**

(h) *Noncommercial Webcaster* is a Licensee that makes eligible digital audio transmissions and:

(1) Is exempt from taxation under section 501 of the Internal Revenue Code of 1986 (26 U.S.C. 501),

(2) Has applied in good faith to the Internal Revenue Service for exemption from taxation under section 501 of the Internal Revenue Code and has a commercially reasonable expectation that such exemption shall be granted, or

(3) Is operated by a State or possession or any governmental entity or subordinate thereof, or by the United States or District of Columbia, for exclusively public purposes.

(i) *Performance* is each instance in which any portion of a sound recording is publicly performed to a ~~Listener~~**listener** by means of a digital audio transmission (e.g., the delivery of any portion of a single track from a compact disc to one ~~Listener~~**listener**) but excluding the following:

(1) A performance of a sound recording that does not require a license (e.g., a sound recording that is not copyrighted);

(2) A performance of a sound recording for which the service has previously obtained a license from the Copyright Owner of such sound recording; and

(3) An incidental performance that both:

(i) Makes no more than incidental use of sound recordings including, but not limited to, brief musical transitions in and out of commercials or program segments, brief performances during news, talk and sports programming, brief

background performances during disk jockey announcements, brief performances during commercials of sixty seconds or less in duration, or brief performances during sporting or other public events and

(ii) Other than ambient music that is background at a public event, does not contain an entire sound recording and does not feature a particular sound recording of more than thirty seconds (as in the case of a sound recording used as a theme song).

(j) *Performers* means the independent administrators identified in 17 U.S.C. 114(g)(2)(B) and (C) and the parties identified in 17 U.S.C. 114(g)(2)(D).

(k) *Qualified Auditor* is a Certified Public Accountant.

(l) *Side Channel* is a channel on the website of a ~~broadcaster~~**Broadcaster** which channel transmits eligible transmissions that are not simultaneously transmitted over the air by the ~~broadcaster~~**Broadcaster**.

**§ 380.3 Royalty fees for the public performance of sound recordings and for ephemeral recordings.**

(a) ***Royalty rates.*** Royalty rates and fees for eligible digital transmissions of sound recordings made pursuant to 17 U.S.C. 114, and the making of ephemeral recordings pursuant to 17 U.S.C. 112**(e)** are as follows:

(1) *Commercial Webcasters:* ~~(i) The per-performance fee for 2006-2010:~~ For all digital audio transmissions, including simultaneous digital audio retransmissions of over-the-air AM or FM radio broadcasts, **and related Ephemeral Recordings,** a Commercial Webcaster will pay a **royalty of: $.0021 per performance for 2011, $.0023 per performance for 2012, $.0025 per performance for 2013, $.0027 per performance for 2014, and $.0029 per performance for 2015.** ~~performance royalty of: $.0008 per performance for 2006, $.0011 per performance for 2007, $.0014 per performance for 2008, $.0018 per performance for 2009, and $.0019 per performance for 2010. The royalty payable under 17 U.S.C. 112 for any reproduction of a phonorecord made by a Commercial Webcaster during this license period and used solely by the Commercial Webcaster to facilitate transmissions for which it pays royalties as and when provided in this section is deemed to be included within such royalty payments.~~

~~(ii) Optional transitional Aggregate Tuning Hour fee for 2006-2007: The following Aggregate Tuning Hours (ATH) usage rate calculation options, in lieu of the per-performance fee, are available for the transition period of 2006 and 2007:~~

| | ~~Other programming~~ | ~~Broadcast simulcast programming~~ | ~~Non-music programming~~ |
|---|---|---|---|
| ~~Prior Fees~~ | ~~$0.0117 per ATH~~ | ~~$0.0088 per ATH~~ | ~~$0.000762 per ATH.~~ |

| | | | |
|---|---|---|---|
| ~~2006~~ | ~~$0.0123 per ATH~~ | ~~$0.0092 per ATH~~ | ~~$0.0008 per ATH.~~ |
| ~~2007~~ | ~~$0.0169 per ATH~~ | ~~$0.0127 per ATH~~ | ~~$0.0011 per ATH.~~ |

~~(iii) "Non-Music Programming" is defined as Broadcaster programming reasonably classified as news, talk, sports or business programming; "Broadcast Simulcast Programming" is defined as Broadcaster simulcast programming not reasonably classified as news, talk, sports or business programming; and "Other Programming" is defined as programming other than either Broadcaster simulcast programming or Broadcaster programming reasonably classified as news, talk, sports or business programming.~~

(2) *Noncommercial Webcasters:* (i) For all digital audio transmissions ~~totaling~~**totalling** not more than 159,140 Aggregate Tuning Hours (ATH) in a month, including simultaneous digital audio retransmissions of over-the-air AM or FM radio broadcasts, **and related Ephemeral Recordings,** a Noncommercial Webcaster will pay an annual per channel or per station performance royalty of $500 in ~~2006, 2007, 2008, 2009 and 2010.~~**2011, 2012, 2013, 2014 and 2015.**

(ii) For all digital audio transmissions ~~totaling~~**totalling** in excess of 159,140 Aggregate Tuning Hours (ATH) in a month, including simultaneous digital audio retransmissions of over-the-air AM or FM radio broadcasts, **and related Ephemeral Recordings,** a Noncommercial Webcaster will pay a performance royalty of: **$.0021 per performance for 2011, $.0023 per performance for 2012, $.0025 per performance for 2013, $.0027 per performance for 2014, and $.0029 per performance for 2015.**~~$.0008 per performance for 2006, $.0011 per performance for 2007, $.0014 per performance for 2008, $.0018 per performance for 2009, and $.0019 per performance for 2010.~~

~~(iii) The following Aggregate Tuning Hours (ATH) usage rate calculation options, in lieu of the per performance fee, are available for the transition period of 2006 and 2007:~~

| | ~~Other programming~~ | ~~Broadcast simulcast programming~~ | ~~Non-music programming~~ |
|---|---|---|---|
| ~~Prior Fees~~ | ~~$0.0117 per ATH~~ | ~~$0.0088 per ATH~~ | ~~$0.000762 per ATH.~~ |
| ~~2006~~ | ~~$0.0123 per ATH~~ | ~~$0.0092 per ATH~~ | ~~$0.0008 per ATH.~~ |
| ~~2007~~ | ~~$0.0169 per ATH~~ | ~~$0.0127 per ATH~~ | ~~$0.0011 per ATH.~~ |

~~(iv) "Non-Music Programming" is defined as Broadcaster programming reasonably classified as news, talk, sports or business programming; "Broadcast Simulcast Programming" is defined as Broadcaster simulcast programming not reasonably classified as news, talk, sports or business programming; and "Other Programming" is defined as programming other than either Broadcaster simulcast programming or Broadcaster programming reasonably classified as news, talk, sports or business programming.~~

~~(v) The royalty payable under 17 U.S.C. 112 for any reproduction of a phonorecord made by a Noncommercial Webcaster during this license period and used solely by the Noncommercial Webcaster to facilitate transmissions for which it pays royalties as and when provided in this section is deemed to be included within such royalty payments.~~

(b) *Minimum fee*—(1) *Commercial Webcasters*. Each Commercial Webcaster will pay an annual, nonrefundable minimum fee of $500 for each calendar year or part of a calendar year of the period ~~2006-2010~~**2011-2015** during which it is a Licensee pursuant to 17 U.S.C. 112(e) or 114. This annual minimum fee is payable for each individual channel and each individual station maintained by Commercial Webcasters, and is also payable for each individual Side Channel maintained by Broadcasters who are Commercial Webcasters, provided that a Commercial Webcaster shall not be required to pay more than $50,000 per calendar year in minimum fees in the aggregate (for 100 or more channels or stations). ~~The minimum fee payable under 17 U.S.C. 112 is deemed to be included within the minimum fee payable under 17 U.S.C. 114.~~**For each such Commercial Webcaster, the annual minimum fee described in this paragraph shall constitute the minimum fees due under both 17 U.S.C. §§ 112(e)(4) and 114(f)(2)(B).** Upon payment of the minimum fee, the Commercial Webcaster will receive a credit in the amount of the minimum fee against any **additional** royalty fees payable in the same calendar year.

(2) *Noncommercial Webcasters*. Each Noncommercial Webcaster will pay an annual, nonrefundable minimum fee of $500 for each calendar year or part of a calendar year of the ~~license~~ period **2011-2015** during which ~~they are Licensees~~**it is a Licensee** pursuant to ~~licenses under~~ 17 U.S.C. **112(e) or** 114. This annual minimum fee is payable for each individual channel and each individual station maintained by Noncommercial Webcasters, and is also payable for each individual Side Channel maintained by Broadcasters who are **Noncommercial Webcasters.**~~Licensees. The minimum fee payable under 17 U.S.C. 112 is deemed to be included within the minimum fee payable under 17 U.S.C. 114.~~**For each such Commercial Webcaster, the annual minimum fee described in this paragraph shall constitute the minimum fees due under both 17 U.S.C. §§ 112(e)(4) and 114(f)(2)(B).** Upon payment of the minimum fee, the ~~Licensee~~**Noncommercial Webcaster** will receive a credit in the amount of the minimum fee against any additional royalty fees payable in the same calendar year.

**(c) *Ephemeral recordings*. The royalty payable under 17 U.S.C. 112(e) for the making of all Ephemeral Recordings used by the Licensee solely to facilitate transmissions for which it pays royalties shall be included within, and constitute 5% of, the total royalties payable under §§ 112(e) and 114.**

**§ 380.4 Terms for making payment of royalty fees and statements of account.**

(a) *Payment to the Collective*. A Licensee shall make the royalty payments due under § 380.3 to the Collective.

(b) *Designation of the Collective*. (1) Until such time as a new designation is made, SoundExchange, Inc., is designated as the Collective to receive statements of account and royalty

payments from Licensees due under § 380.3 and to distribute such royalty payments to each Copyright Owner and Performer, or their designated agents, entitled to receive royalties under 17 U.S.C. 112(e) or 114(g).

(2) If SoundExchange, Inc. should dissolve or cease to be governed by a board consisting of equal numbers of representatives of Copyright Owners and Performers, then it shall be replaced by a successor Collective upon the fulfillment of the requirements set forth in paragraph (b)(2)(i) of this section.

(i) By a majority vote of the nine Copyright Owner representatives and the nine Performer representatives on the SoundExchange board as of the last day preceding the condition precedent in paragraph (b)(2) of this section, such representatives shall file a petition with the Copyright Royalty ~~Board~~**Judges** designating a successor to collect and distribute royalty payments to Copyright Owners and Performers entitled to receive royalties under 17 U.S.C. 112(e) or 114(g) that have themselves authorized ~~such~~**the** Collective.

(ii) The Copyright Royalty Judges shall publish in the Federal Register within 30 days of receipt of a petition filed under paragraph (b)(2)(i) of this section an order designating the Collective named in such petition.

(c) *Monthly payments*. A Licensee shall make any payments due under § 380.3 ~~by~~**on a monthly basis on or before** the 45th day after the end of each month for that month~~, except that payments due under § 380.3 for the period beginning January 1, 2006, through the last day of the month in which the Copyright Royalty Judges issue their final determination adopting these rates and terms shall be due 45 days after the end of such period~~. All monthly payments shall be rounded to the nearest cent.

(d) *Minimum payments*. A Licensee shall make any minimum payment due under § 380.3(b) by January 31 of the applicable calendar year, except that~~:~~

~~(1) Payment due under § 380.3(b) for 2006 and 2007 shall be due 45 days after the last day of the month in which the Copyright Royalty Judges issue their final determination adopting these rates and terms.~~

~~(2) Payment~~ **payment** for a Licensee that has not previously made eligible nonsubscription transmissions, noninteractive digital audio transmissions as part of a new subscription service or Ephemeral Recordings pursuant to the licenses in 17 U.S.C. 114 and/or 17 U.S.C. 112(e) shall be due by the 45th day after the end of the month in which the Licensee commences to do so.

(e) *Late payments and statements of account*. A Licensee shall pay a late fee of 1.5% per month, or the highest lawful rate, whichever is lower, for any payment**, statement of account** and/or ~~statement of account~~**report of use pursuant to § 370.4** received by the Collective after the due date. Late fees shall accrue from the due date until payment ~~is~~**and the related statement of account and report of use are** received by the Collective.

(f) *Statements of account.* Any payment due under § 380.3 shall be accompanied by a corresponding statement of account **on a form made available by the Collective**. **Each payment and related statement of account and report of use pursuant to § 370.4 must cover the same scope of activity (e.g., the same Licensee and the same channels or stations).** A statement of account shall contain the following information:

(1) **The name of the Licensee, in exactly the way it appears on the relevant notice of use pursuant to § 370.2 and report of use pursuant to § 370.4;**

**(2) The account number assigned to the Licensee by the Collective, if the Licensee has been notified of such account number by the Collective;**

**(3)** Such information as is necessary to calculate the accompanying royalty payment;

(~~2~~**4**) The name, address, business title, telephone number, facsimile number (if any), electronic mail address and other contact information of the person to be contacted for information or questions concerning the content of the statement of account;

(~~3~~**5**) The ~~handwritten~~ signature of:

(i) The owner of the Licensee or a duly authorized agent of the owner, if the Licensee is not a partnership or corporation;

(ii) A partner or delegee, if the Licensee is a partnership; or

(iii) An officer of the corporation, if the Licensee is a corporation.

(~~4~~**6**) The printed or typewritten name of the person signing the statement of account;

(~~5~~**7**) The date of signature;

(~~6~~**8**) If the Licensee is a partnership or corporation, the title or official position held in the partnership or corporation by the person signing the statement of account;

(~~7~~**9**) A certification of the capacity of the person signing; and

(~~8~~**10**) A statement to the following effect:

I, the undersigned owner or agent of the Licensee, or officer or partner, have examined this statement of account and hereby state that it is true, accurate, and complete to my knowledge after reasonable due diligence.

(g) *Distribution of royalties.* (1) The Collective shall promptly distribute royalties received from Licensees to Copyright Owners and Performers, or their designated agents, that are entitled to such royalties. The Collective shall only be responsible for making distributions to those Copyright Owners, Performers, or their designated agents who provide the Collective with such information as is necessary to identify the correct recipient. The Collective shall distribute royalties on a basis that values all performances by a Licensee equally based upon the information provided under the reports of use requirements for Licensees contained in § 370.3 of this chapter.

(2) If the Collective is unable to locate a Copyright Owner or Performer entitled to a distribution of royalties under paragraph (g)(1) of this section within 3 years from the date of payment by a Licensee, such ~~distribution may first be applied to the costs directly attributable to the administration of that distribution. The foregoing shall apply notwithstanding the common law or statutes of any State.~~**royalties shall be handled in accordance with § 380.8.**

(h) *Retention of records.* Books and records of a Licensee and of the Collective relating to payments of and distributions of royalties shall be kept for a period of not less than the prior 3 calendar years. **Such books and records of the Licensee shall include original server logs sufficient to substantiate all rate calculation and reporting, and must be made available to the Collective's Qualified Auditor in the event of an audit pursuant to § 380.6.**

**§ 380.5 Confidential information.**

(a) *Definition.* For purposes of this part, "Confidential Information" shall include the statements of account and any information contained therein, including the amount of royalty payments, and any information pertaining to the statements of account reasonably designated as confidential by the Licensee submitting the statement.

(b) *Exclusion.* Confidential Information shall not include documents or information that at the time of delivery to the Collective are public knowledge. The party claiming the benefit of this provision shall have the burden of proving that the disclosed information was public knowledge.

(c) *Use of Confidential Information.* In no event shall the Collective use any Confidential Information for any purpose other than royalty collection and distribution and activities related directly thereto.

(d) *Disclosure of Confidential Information.* Access to Confidential Information shall be limited to:

(1) Those employees, agents, attorneys, consultants and independent contractors of the Collective, subject to an appropriate confidentiality agreement, who are engaged in the collection and distribution of royalty payments hereunder and activities related thereto, for the purpose of performing such duties during the ordinary course of their work and who require access to the Confidential Information;

(2) An independent and Qualified Auditor, subject to an appropriate confidentiality agreement, who is authorized to act on behalf of the Collective with respect to verification of a Licensee's statement of account pursuant to § 380.6 or on behalf of a Copyright Owner or Performer with respect to the verification of royalty distributions pursuant to § 380.7;

(3) Copyright Owners and Performers, including their designated agents, whose works have been used under the statutory licenses set forth in 17 U.S.C. 112(e) and 114~~(f)~~ by the Licensee whose Confidential Information is being supplied, subject to an appropriate confidentiality agreement, and including those employees, agents, attorneys, consultants and independent contractors of such Copyright Owners and Performers and their designated agents, subject to an appropriate confidentiality agreement, for the purpose of performing their duties during the ordinary course of their work and who require access to the Confidential Information; and

(4) In connection with future proceedings under 17 U.S.C. 112(e) and 114~~(f)~~ before the Copyright Royalty Judges, and under an appropriate protective order, attorneys, consultants and other authorized agents of the parties to the proceedings or the courts.

(e) *Safeguarding of Confidential Information.* The Collective and any person identified in paragraph (d) of this section shall implement procedures to safeguard against unauthorized access to or dissemination of any Confidential Information using a reasonable standard of care, but no less than the same degree of security used to protect Confidential Information or similarly sensitive information belonging to the Collective or person.

**§ 380.6 Verification of royalty payments.**

(a) *General.* This section prescribes procedures by which the Collective may verify the royalty payments made by a Licensee.

(b) *Frequency of verification.* The Collective may conduct a single audit of a Licensee, upon reasonable notice and during reasonable business hours, during any given calendar year, for any or all of the prior 3 calendar years, but no calendar year shall be subject to audit more than once.

(c) *Notice of intent to audit.* The Collective must file with the Copyright Royalty ~~Board~~**Judges** a notice of intent to audit a particular Licensee, which shall, within 30 days of the filing of the notice, publish in the Federal Register a notice announcing such filing. The notification of intent to audit shall be served at the same time on the Licensee to be audited. Any such audit shall be conducted by an independent and Qualified Auditor identified in the notice, and shall be binding on all parties.

(d) *Acquisition and retention of report.* The Licensee shall use commercially reasonable efforts to obtain or to provide access to any relevant books and records maintained by third

parties for the purpose of the audit. The Collective shall retain the report of the verification for a period of not less than 3 years.

(e) *Acceptable verification procedure.* An audit, including underlying paperwork, which was performed in the ordinary course of business according to generally accepted auditing standards by an independent and Qualified Auditor, shall serve as an acceptable verification procedure for all parties with respect to the information that is within the scope of the audit.

(f) *Consultation.* Before rendering a written report to the Collective, except where the auditor has a reasonable basis to suspect fraud and disclosure would, in the reasonable opinion of the auditor, prejudice the investigation of such suspected fraud, the auditor shall review the tentative written findings of the audit with the appropriate agent or employee of the Licensee being audited in order to remedy any factual errors and clarify any issues relating to the audit; Provided that an appropriate agent or employee of the Licensee reasonably cooperates with the auditor to remedy promptly any factual errors or clarify any issues raised by the audit.

(g) *Costs of the verification procedure.* The Collective shall pay the cost of the verification procedure, unless it is finally determined that there was an underpayment of 10% or more, in which case the Licensee shall, in addition to paying the amount of any underpayment, bear the reasonable costs of the verification procedure.

**§ 380.7 Verification of royalty distributions.**

(a) *General.* This section prescribes procedures by which any Copyright Owner or Performer may verify the royalty distributions made by the Collective; Provided, however, that nothing contained in this section shall apply to situations where a Copyright Owner or Performer and the Collective have agreed as to proper verification methods.

(b) *Frequency of verification.* A Copyright Owner or Performer may conduct a single audit of the Collective upon reasonable notice and during reasonable business hours, during any given calendar year, for any or all of the prior 3 calendar years, but no calendar year shall be subject to audit more than once.

(c) *Notice of intent to audit.* A Copyright Owner or Performer must file with the Copyright Royalty ~~Board~~**Judges** a notice of intent to audit the Collective, which shall, within 30 days of the filing of the notice, publish in the Federal Register a notice announcing such filing. The notification of intent to audit shall be served at the same time on the Collective. Any audit shall be conducted by an independent and Qualified Auditor identified in the notice, and shall be binding on all Copyright Owners and Performers.

(d) *Acquisition and retention of report.* The Collective shall use commercially reasonable efforts to obtain or to provide access to any relevant books and records maintained by third parties for the purpose of the audit. The Copyright Owner or Performer requesting the verification procedure shall retain the report of the verification for a period of not less than 3 years.

(e) *Acceptable verification procedure.* An audit, including underlying paperwork, which was performed in the ordinary course of business according to generally accepted auditing standards by an independent and Qualified Auditor, shall serve as an acceptable verification procedure for all parties with respect to the information that is within the scope of the audit.

(f) *Consultation.* Before rendering a written report to a Copyright Owner or Performer, except where the auditor has a reasonable basis to suspect fraud and disclosure would, in the reasonable opinion of the auditor, prejudice the investigation of such suspected fraud, the auditor shall review the tentative written findings of the audit with the appropriate agent or employee of the Collective in order to remedy any factual errors and clarify any issues relating to the audit; Provided that the appropriate agent or employee of the Collective reasonably cooperates with the auditor to remedy promptly any factual errors or clarify any issues raised by the audit.

(g) *Costs of the verification procedure.* The Copyright Owner or Performer requesting the verification procedure shall pay the cost of the procedure, unless it is finally determined that there was an underpayment of 10% or more, in which case the Collective shall, in addition to paying the amount of any underpayment, bear the reasonable costs of the verification procedure.

**§ 380.8 Unclaimed funds.**

If the Collective is unable to identify or locate a Copyright Owner or Performer who is entitled to receive a royalty distribution under this part, the Collective shall retain the required payment in a segregated trust account for a period of 3 years from the date of distribution. No claim to such distribution shall be valid after the expiration of the 3-year period. After expiration of this period, the Collective may apply the unclaimed funds to offset any costs deductible under 17 U.S.C. 114(g)(3). The foregoing shall apply notwithstanding the common law or statutes of any State.

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**Before the**
**UNITED STATES COPYRIGHT ROYALTY JUDGES**
**Washington, D.C.**

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| In the Matter of:<br><br>Digital Performance Right in Sound Recordings and Ephemeral Recordings | Docket No. 2009-1<br>CRB Webcasting III |

**WRITTEN REBUTTAL TESTIMONY OF**

# JANUSZ ORDOVER

**Professor of Economics**
**and former Director of the Masters in Economics Program at New York University**

**June 2010**

## I. Introduction and Qualifications

1. My name is Janusz A. Ordover. I am Professor of Economics and former Director of the Masters in Economics Program at New York University, where I have taught since 1973.[1] During 1991-92, I served as Deputy Assistant Attorney General for Economics at the Antitrust Division of the United States Department of Justice. As the chief economist for the Antitrust Division, I was responsible for formulating and implementing the economic aspects of antitrust policy and enforcement of the United States, including co-drafting the 1992 U.S. Department of Justice and Federal Trade Commission Horizontal Merger Guidelines. I also had ultimate responsibility for all of the economic analyses conducted by the Department of Justice in connection with its antitrust investigations and litigation.

2. My areas of specialization include industrial organization economics, particularly antitrust and regulatory economics. I served on the Board of Editors of *Antitrust Report* and as an advisor on antitrust, regulatory, and intellectual property issues to many organizations, including the American Bar Association, the World Bank, the Organization for Economic Cooperation and Development (OECD), the Inter-American Development Bank, and the governments of Poland, Hungary, Russia, the Czech Republic, Australia, and other countries. I have provided economic testimony in policy hearings conducted by the Federal Trade Commission and the United States Senate.

3. Finally, I have on numerous occasions served as a consulting or testifying expert in matters involving the music, and other content, industries. In this regard, I previously served as an expert economist for SoundExchange in its proceeding with

[1] A copy of my *curriculum vitae* and a list of recent testimony are attached as Appendix One.

the satellite radio operators,[2] and for Sony and BMG in connection with their recorded music joint venture. I also testified on behalf of Universal Music in support of the company's petition to adjust the royalty rate for mechanical rights in the European Union, and in connection with the FTC's investigation of the Three Tenors joint venture. I have conducted several analyses of issues relating to the distribution and pricing of content in the cable television industry, and have written and testified in many proceedings dealing with pricing of access to telecommunications networks. Finally, I served as an economic consultant to the Commission on New Technological Uses of Copyrighted Works (CONTU) with respect to the pricing of copyrighted materials.

## II. Assignment and Overview of Testimony

### A. Assignment

4. I have been asked by SoundExchange, through its counsel, to assess from an economic perspective the opinions and analyses put forward by Dr. Mark Fratrik, the economic expert for Live365. My review of Dr. Fratrik's testimony focused principally on two areas: (i) his proposed methodology for developing a schedule of royalty rates over the period 2011-2015 for the compulsory license covering digital audio transmission of sound recordings by statutory webcasters; and (ii) his conclusion that the rates negotiated between SoundExchange and the NAB do not fall within the range of rates consistent with the willing buyer/willing seller standard that guides the Copyright Royalty Judges' (the "Judges") determination in this matter.

### B. Summary of Conclusions

5. Based on my review and consideration of Dr. Fratrik's testimony, I have reached the following key conclusions.

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[2] In the Matter of Determination Of Rates And Terms For Preexisting Subscription Services And Satellite Digital Audio Radio Services, Docket No. 2006-1 CRB DSTRA ("SDARS Proceeding").

6. To begin with, the methodology Dr. Fratrik employs to develop his recommended rates is severely flawed in several respects.

   a. First, Dr. Fratrik's framework is premised on his assertion that Live365 is a representative (or typical) webcaster.[3] This assertion is implausible. The webcasting industry is highly diverse, especially with respect to the business models employed by webcasters. Given this diversity in business models, Dr. Fratrik's assumption that Live365 is somehow typical is unsupported and untenable, particularly because Live365's business model integrates webcasting and broadcasting services in a manner that is, to my knowledge, unusual if not unique. There is no reason to think that Live365's operating costs and subscription revenues, as well as the percentage breakdown in Live365's revenues between advertising and subscription, can serve as reasonable proxies for webcasters more generally.

   b. Second, Dr. Fratrik's framework seeks to determine a rate for digital performance rights that is calibrated in such a way as to permit a webcaster to earn a minimum expected operating margin of 20%. I see no sound economic principle guiding the willing buyer/willing seller construct that is consistent with such an approach. Dr. Fratrik's selection of a minimum expected margin of 20% is based on margins earned by terrestrial radio broadcasters, who operate in a market with higher fixed capital and other costs and therefore do not provide a useful benchmark from which to determine a reasonable operating margin.

7. My second key conclusion is that the voluntarily negotiated licensing deals between SoundExchange and the National Association of Broadcasters (and Sirius-

[3] *See, e.g.*, Hearing Transcript – Volume VI, April 27, 2010, at p. 1105; Corrected & Amended Testimony of Mark R. Fratrik, Ph.D., February 15, 2010 ("Fratrik Corrected & Amended Testimony"), at p. 16.

XM)[4] should inform the Judges' determination of a rate schedule for other webcasters who are parties to the 2011-2015 Webcasting Proceeding.[5] Dr. Fratrik asserts that the Judges should not consider, without substantial adjustment, the voluntary agreement between SoundExchange and the NAB governing the rates and terms for simulcasts of terrestrial radio signals (the "NAB Agreement").[6] However, he fails to support his criticisms of the NAB Agreement with sound economic analysis. Indeed, his criticisms are inconsistent with standard economic theory. As I demonstrate later in this report, the rates from the NAB agreement are highly probative of rates consistent with the statutory standard.

a. Dr. Fratrik asserts that the NAB Agreement provides little useful information because the broadcasters who are the beneficiaries of that Agreement have a lower cost structure than commercial webcasters such as Live365. Even if that is true – an issue on which I do not opine – it does not matter because SoundExchange cannot directly control the magnitude of listener consumption at each of the services, *i.e.*, SoundExchange cannot take measures to limit listening at services that pay a low rate. Consequently, SoundExchange would be unlikely to agree to rates below those in the NAB Agreement. In other words, while SoundExchange can agree to different rates across webcasters, it cannot control the consumption of music on the various webcasting services. Thus, a relatively low rate offered to one webcaster, insofar as that rate makes the webcaster a more effective competitor in the marketplace, can shift demand away from webcasters who are paying higher rates, quite likely leading to a reduction in total royalty payments collected by SoundExchange from statutory webcasters.

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[4] *See, e.g.*, Broadcaster Webcasting Settlement Agreement, February 15, 2009 (SXW3_00000978 – 00001001) ("NAB Agreement"); Commercial Webcasting Settlement Agreement between SoundExchange, Inc. and Sirius XM Radio, July 30, 2009 (SXW3_00001908 – 00001916) ("Sirius-XM Agreement").

[5] In the Matter of Digital Performance Right in Sound Recordings and Ephemeral Recordings, Docket No. 2009-1 CRB Webcasting III ("Webcasting III").

[6] Fratrik Corrected & Amended Testimony at pp. 40-44.

b. Dr. Fratrik also suggests that the parties' desire to avoid the costs of litigation, and the fact that the buyers obtained a limited performance complement waiver from each of the four major record companies, may have had an impact on the ultimately negotiated rate. In my opinion it is not likely that such considerations lowered the negotiated rates. This is so because the parties likely both wished to avoid the costs of litigation, and the performance complement waivers provided benefits to both the buyers and the record companies.

c. The statutory standard raises a theoretical issue pertaining to the applicability of the rates recently negotiated between SoundExchange and the NAB because these rates were negotiated in the shadow of regulatory intervention in the event of disagreement over the appropriate rate, *i.e.*, against the backdrop of prior regulatory proceedings and with an understanding that unsuccessful negotiations would lead to regulatory intervention and rates established by the regulatory process.[7] Consistent with my testimony in the SDARS Proceeding,[8] and more generally with a sound economic approach to the determination of rates that best conduce to long-run economic efficiency, licensing rates negotiated in an unfettered marketplace, that is, in a marketplace free of regulatory compulsion and undue market power on either side of the bargaining table, represent benchmarks that are most closely aligned with the statutory requirement. Nevertheless, it is my view that the rates negotiated between SoundExchange and the NAB, under the circumstances presented here, are

[7] It is my understanding that the Judges are governed by a statutory standard that directs them to determine rates and terms that "most clearly represent" those "that would have been negotiated in the marketplace between a willing buyer and a willing seller. 17 U.S.C. § 114(f)(2)(B). The hypothetical marketplace envisioned by the standard is one in which there is no requirement for a statutory license. *See, e.g.*, Final Rule and Order, In the Matter of Digital Performance Right In Sound Recordings And Ephemeral Recordings, Docket No. 2005-1 CRB DTRA, 72 Fed. Reg. 24084, 24091 (May 1, 2007).

[8] Testimony of Janusz Ordover, In the Matter of Adjustment of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services, Docket No. 2006-1 CRB DSTRA, October 30, 2006; Rebuttal Testimony of Janusz Ordover, In the Matter of Adjustment of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services, Docket No. 2006-1 CRB DSTRA, July 23, 2007.

useful and probative insofar as they provide corroboration of what I would consider as appropriate market-based rates.

d. In addition, the statutory standard, as interpreted by the Judges, raises a second theoretical issue because the NAB Agreement involved on the seller side the record companies negotiating under the auspices of SoundExchange. The statutory standard, on the other hand, contemplates on the seller side the individual record companies each separately licensing its own catalog of sound recordings.[9] In the circumstances of this case, however, where the NAB companies needed to acquire rights from all four major record companies, economic theory indicates that SoundExchange might well have offered a lower royalty than the aggregate rate that NAB could have obtained had it negotiated separately with each of the four major record companies.

8. In the remainder of this report, I discuss more fully the general conclusions summarized above.

## III. Dr. Fratrik's Methodology

### A. Overview

9. Dr. Fratrik's proposed methodology for determining compulsory license rates rests on the premise that a webcaster is entitled to earn a "fair operating margin" and that the royalty rate for music should be set in such a way as to ensure (presumably in the expected value sense) that the webcaster earns such a rate.[10] In order to calculate such a rate, he analyzes the revenue and cost data for Live365, which he treats as a reasonable proxy for the financial performance of webcasters more generally.[11] That is, he concludes that the rates derived on the

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[9] Final Rule and Order, In the Matter of Digital Performance Right In Sound Recordings And Ephemeral Recordings, Docket No. 2005-1 CRB DTRA, 72 Fed. Reg. 24084, 24091 (May 1, 2007).

[10] Fratrik Corrected & Amended Testimony at p. 5.

[11] Id. at pp. 4-5; Fratrik Deposition at pp. 65-66, 165.

basis of Live365's revenue and cost data can be used to calculate the rates for other webcasters.

10. Dr. Fratrik presents three different versions of calculations to derive a recommended royalty. In the first, he uses all components of Live365's revenues and costs allegedly related to its webcasting operations, except the royalty payments due to SoundExchange pursuant to the compulsory license that is the subject of this proceeding. He also includes as an element of cost a guaranteed operating margin (operating income/revenues) of 20% net of all costs, including digital performance royalty payments. This enables him to calculate the royalty rate and resulting royalty payments at which Live365, based upon its fiscal year 2008 webcasting operations,[12] would have achieved a net operating margin of 20%.[13] Dr. Fratrik's second and third versions use estimates of total Internet radio advertising revenues rather than company-specific data for Live365; in each version he uses Live365 subscription revenue and operating cost data.[14]

11. Dr. Fratrik's methodology, and hence the recommended royalty rate derived from it, is deeply flawed as a matter of economics. The specific critiques that I offer below are not an exhaustive list of the problems in Dr. Fratrik's analysis, but merely represent some of the more glaring and critical flaws.

**B. Conceptual Flaws in Dr. Fratrik's Methodology**

12. The starting point for Dr. Fratrik's proposed framework is his assumption that Live365 is a typical webcaster in terms of its operating costs and subscriber revenues. Dr. Fratrik offers no analysis in support of this assertion.[15] Rather, he

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[12] Live365's fiscal year 2008 covers the period October 1, 2007 through September 30, 2008. (Fratrik Corrected & Amended Testimony at p. 18.)

[13] Fratrik Corrected & Amended Testimony at p. 21 (Table 2).

[14] Id. at p. 26 (Table 4) and p. 28 (Table 5).

[15] *See, e.g.*, Hearing Transcript – Volume VI, April 27, 2010, at p. 1224 (Dr. Fratrik has not verified that Live365's costs are typical of other webcasters.).

bases his assumption on the fact that Live365 is a relatively mature webcaster, *i.e.*, it has operated as a webcaster for more than ten years, has reached a scale of operation sufficient to realize certain scale economies, and has recently executed various cost-cutting measures.[16] Of course, Live365's longevity does not imply its "typicality" as a webcaster.

13. Even a cursory assessment of the webcasting industry makes clear that Dr. Fratrik's characterization of Live365 as a typical webcaster is not defensible. With respect to Live365 itself, Dr. Fratrik claims that the company operates a webcasting business that generates revenues from both advertising and subscriptions, and a so-called "broadcast-services" business that generates an additional revenue stream related to the provision of services that enable operators of individual Internet radio stations to promote and transmit their programming to listeners.[17] Live365's provision of broadcast services is relatively unique among statutory webcasters. Moreover, unlike almost all other statutory webcasters, Live365 does not develop its own programming and thus does not incur the costs associated with such efforts. Instead of providing its own programming, Live365 operates as an aggregator of thousands of individual webcasters that independently program their own channels. Those webcasters that sign up with Live365 are listed on the company's directory of available channels.[18]

14. Dr. Fratrik ignores the broadcast-services portion of Live365's business by attempting to construct a financial profile limited to the company's webcasting operation. Such an exercise is necessarily arbitrary and unreasonable in my view

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[16] Fratrik Corrected & Amended Testimony at p. 16; Hearing Transcript – Volume VI, April 27, 2010, at p. 1105.

[17] In analyzing Live365's business model, and specifically its division of its business into two components, I am relying on the definitions offered by Live365. I understand that Live365 classifies as "broadcast-services" the components of its business that individual webcasters purchase to allow them to webcast through Live365. (Deposition of N. Mark Lam, January 28, 2010 ("Lam Deposition"), at pp. 24-28; Hearing Transcript – Volume VI, April 27, 2010, at pp. 1204-09.)

[18] Lam Deposition at pp. 34-38.

because it disregards the wholly integrated (*i.e.*, synergistic) nature of Live365's business. In particular, Live365's webcasting service helps it to promote its broadcasting services, and the royalty rate that Live365 would be willing to pay necessarily is influenced by the revenue it generates through its broadcasting services.[19] As a result, even if one assumes (contrary to sound economics) that Live365's financial performance has some relevance for purposes of determining a reasonable rate (or range of rates) in this proceeding, an assessment of the company's financial performance should not arbitrarily attempt to carve out the webcasting segment of the overall business.

15. As the above description of Live365's business model shows, it is not a "typical" webcaster – assuming even that a typical webcaster exists – in any material sense because it combines webcasting with broadcast services that few if any other webcasters offer. More broadly, webcasters operate a number of different business models, which makes it improper to characterize Live365 as typical of the whole. I will quickly note several different types of webcasters to illustrate the point that Live365 reasonably cannot serve as a proxy for webcasters in general.

    a. *Simulcasters*: A number of terrestrial radio broadcasters transmit their programming over the Internet. These services typically are available for free (ad-supported basis), *i.e.*, there is no subscription option available. Besides generating revenues directly through ad sales, an online simulcast benefits the broadcaster to the extent it helps the broadcaster to maintain or gain terrestrial audience.[20]

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[19] Dr. Fratrik's allocation of the joint and common costs of operating Live365's business and the revenues it generates highlights the synergistic nature of the two components of the business that Dr. Fratrik arbitrarily attempts to segregate. Specifically, customers of Live365's broadcasting services, *i.e.*, independent webcasters who pay Live365 to transmit their channels, pay fees to Live365 intended to cover the royalties incurred through their webcasting channels and the accompanying bandwidth. Under this arrangement, Live365 is actually paid fees by its broadcasting-services customers that cover the most fundamental costs incurred by all webcasters. Yet in his calculations, Dr. Fratrik excludes all revenue related to broadcasting services, but at the same time allocates all of the costs associated with, among other things, bandwidth, to the webcasting service. (Hearing Transcript – Volume VI, April 27, 2010, at pp. 1190-92, 1210-18, 1275.)

[20] Insofar as Internet radio competes with terrestrial broadcasts, simulcasting provides a terrestrial broadcaster with an ability to internalize some listener substitution to Internet radio.

b. *Portals*: Companies like AOL and Yahoo! provide webcasting services not just to generate advertising and subscription revenues but also to drive traffic to their other revenue-producing websites. Dr. Fratrik acknowledges that the value of music to portals might differ from the value of music to a webcaster like Live365.[21]

c. *Custom radio*: These are webcasting services that provide consumers with a greater degree of control over their listening experience relative to webcasters in general. Dr. Fratrik acknowledges that custom radio services might have higher or lower cost structures relative to Live365. Similarly, he acknowledges that custom radio operators might have a greater or lesser ability to monetize their services.[22]

d. *Services that use statutory webcasting to stimulate sales of another product or service:* Certain firms offer statutory webcasting as a way to entice listeners to purchase another service. A prime example of this type of service is Rhapsody, which offers statutory webcasting as "Rhapsody Radio" in an effort to attract subscribers to its interactive on-demand audio streaming service. Indeed, Live365 uses webcasting to sell its broadcasting services, which appear to be highly profitable.[23]

e. *Traditional Internet-only webcasters*: These webcasters offer only fully pre-programmed, non-customized audio streaming. Some are dedicated to specific genres of music, while others offer a wide variety of programming across multiple genre-specific channels. These services are primarily ad-supported but often also offer monthly subscription-based services that provide higher audio quality and no advertisements.

f. *Subscription Services*: Sirius-XM, the satellite radio service that is only available via subscription, offers webcasting of much of its programming to subscribers. This service operates in a similar manner to simulcasting, in that the webcasted content is also available through another delivery method. But unlike simulcasters, Sirius-XM is subscription-only, and there is no free to the consumer, ad-supported option.

16. The variety of uses of statutory webcasting highlights the serious problems in Dr. Fratrik's assumption that Live365 is typical of this category of services. All of these types of webcasting services compete with each other for listeners and, in many

[21] Hearing Transcript – Volume VI, April 27, 2010, at p. 1239.

[22] Id. at p. 1238.

[23] Id. at p. 1184.

cases, for ad revenue as well.[24] These services are characterized by varying ratios of subscription and ad-supported listening. The substantial degree of heterogeneity across the existing webcasting business models makes any attempt to characterize Live365 as a typical webcaster fatally flawed.

17. The data that Dr. Fratrik ultimately relies upon to calculate his recommended rate further exposes the inherent problem of seeking typicality in the webcasting marketplace. Dr. Fratrik's recommended rate of $0.0009 per performance[25] is derived from Live365's costs and subscription revenue data, and also from industry-wide advertising revenue data reported by ZenithOptimedia.[26] Notably, because Dr. Fratrik's calculations generate a significantly higher advertising revenue per aggregate tuning hour (ATH) using the ZenithOptimedia data as compared to Live365's own data, his recommended rate is above the rate at which Live365 would have earned a 20% operating margin for its webcasting service in its fiscal year 2008. In other words, Dr. Fratrik's methodology is premised on the notion that the rate for digital performance rights should be set at a level that allows a "typical" webcaster (such as Live365, using Dr. Fratrik's framework) to earn a 20% margin, but in the end, his recommended rate does not accomplish this objective because Live365 itself would not earn a 20% margin for its webcasting business under Dr. Fratrik's proposed rate. In fact, at Dr. Fratrik's proposed rate of $0.0009, the operating margin for the fiscal year 2008 for Live365's webcasting business would have been negative.[27]

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[24] Id. at p. 1249.

[25] Dr. Fratrik recommends that a rate of $0.0009 per performance be applied to all "commercial webcasters" in each of the five years during the statutory period (2011-2015). (Fratrik Amended & Corrected Testimony at p. 5.) Dr. Fratrik recommends a different, and lower, rate for "aggregation services," or Internet radio operators that combine at least one hundred small, independently operated webcasters into a single network. (Id. at p. 4.)

[26] Dr. Fratrik does not use Live365's advertising revenue data in the calculations used to generate his recommended rate. (Fratrik Corrected & Amended Testimony at p. 28 (Table 5).)

[27] Fratrik Corrected & Amended Testimony at p. 21 (Table 2).

18. I should also point out Dr. Fratrik's conclusion that a webcaster would be unwilling to license digital performance rights at a rate that results in an operating margin of less than 20%.[28] What this means is that under a literal application of Dr. Fratrik's methodology, Live365 should either exit the webcasting business or continue to webcast only if it is paid by the record labels to play their music.[29] This outcome highlights the fallacy of his treatment of Live365 as a typical webcaster, and more generally demonstrates the unsound nature of his proposed framework.

19. Moreover, the figure for advertising revenue per-ATH calculated by Dr. Fratrik from the ZenithOptimedia data is nearly double the analogous figure generated from Live365's financial data.[30] In any case, whether or not the advertising revenue per-ATH figure from the ZenithOptimedia is representative of a typical webcaster, Dr. Fratrik's methodology is fatally flawed. If the figure is representative of a typical webcaster, the fact that it is nearly two times the analogous value obtained from Live365's financial data precludes Dr. Fratrik from utilizing Live365 as a representative webcaster. If, on the other hand, the figure is not representative of a typical webcaster, then it should not serve as the basis for Dr. Fratrik's recommended rate.

20. In sum, one principal shortcoming of Dr. Fratrik's proposed framework is that it is premised on an assumption that Live365 is a typical webcaster. This assumption is inconsistent with marketplace realities. Even if Dr. Fratrik's assumption about the typicality of Live365 were correct, however, his approach has another serious flaw.

21. Dr. Fratrik's selection of a 20% floor is inconsistent with the relatively low barriers to entry into webcasting. He selects 20% as a "reasonable" operating profit margin

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[28] Fratrik Deposition at p. 174; Hearing Transcript – Volume VI, April 27, 2010, at p. 1164.

[29] This is so because Live365's webcasting operations, according to Table 2 in Dr. Fratrik's Corrected & Amended Testimony, would have earned an operating margin of 20% only if it were paid $0.0003 per performance.

[30] Fratrik Corrected & Amended Testimony at p. 29 (Table 6).

based upon his conclusion that companies in a "comparable" industry – terrestrial radio – earn operating margins, on average, slightly above 20%.[31] However, as Dr. Fratrik acknowledged, the terrestrial radio industry has substantially higher barriers to entry and higher capital costs than webcasting.[32] As Dr. Fratrik concedes, firms in an industry with low barriers to entry and low capital costs will earn lower operating margins, all else being the same, than firms in an industry with high barriers to entry and high capital costs.[33] This is the case because the long-run economic viability of a firm requires recoupment of all of its costs, including fixed costs. When there are high fixed costs and low variable costs, the firm must earn higher operating margins in order to recover its fixed expenditures. Alternatively, when the fixed costs associated with firm's operations are relatively modest, *i.e.*, entry barriers are low, recoupment of fixed costs requires less contribution from the firm's operating margins. In either case, competition is expected to drive margins down toward the point where the firm earns a normal, risk-adjusted rate of return on its invested capital.

22. Highlighting the arbitrariness of Dr. Fratrik's selection of a 20% operating margin benchmark is that Live365, based upon its fiscal year 2008 financials, would be unable to earn such a margin while paying any positive royalty rate. Indeed, SoundExchange would be required to pay Live365 in order to generate Dr. Fratrik's proposed benchmark margin. Of course, Dr. Fratrik does generate a positive recommended rate, but only because he adopts an estimate of industry advertising revenues that is substantially greater than Live365's own data.

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[31] Fratrik Corrected & Amended Testimony at pp. 17, 21-22.

[32] Hearing Transcript – Volume VI, April 27, 2010, at pp. 1168-72.

[33] Id. at pp. 1170-71.

## IV. Dr. Fratrik's Critiques of the SoundExchange-NAB Rates Are Unfounded

23. Dr. Fratrik offers several arguments why the SoundExchange-NAB rates do not, without substantial downward adjustment, reflect an outcome that would obtain through unfettered market bargaining.[34] His arguments are flawed, as I will show presently.

### A. The Higher Cost Structure of Commercial Webcasters

24. Dr. Fratrik's first contention is that the higher cost structure of commercial webcasters as compared to terrestrial broadcasters would make them unwilling to pay rates at the level of those contained in the NAB Agreement.[35] There is, however, no principle underlying the willing buyer/willing seller construct that acts to protect the economic viability of any particular webcaster. If a webcaster is unable to earn an at least normal risk-adjusted rate of return at appropriately determined market-based rates for digital performance rights, then economic efficiency mandates not a lower rate but rather a realignment of the webcaster's business model or its exit from the marketplace.[36]

25. The fact that some webcasters might not be able or willing to pay the rates established in the NAB Agreement because of their cost structure does not necessarily mean that record companies or SoundExchange would offer them a

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[34] Fratrik Corrected & Amended Testimony at pp. 40-41.

[35] Id. at pp. 41-42. For purposes of my discussion I accept as true Dr. Fratrik's assertion that commercial webcasters do indeed have higher cost structures. In doing so, I do not convey my agreement with this assertion.

[36] One might argue that the incremental cost of licensing digital performance rights to any given webcaster is zero, and thus that economic efficiency is enhanced by licensing the rights to a webcaster at any rate that covers this incremental cost. Such an argument is flawed for several reasons. First, relevant incremental cost in this instance is not necessarily zero because lower (or zero) rates provided to higher-cost webcaster can distort competitive forces in the downstream market (distribution of music to listeners), *i.e.*, shift listener demand away from lower-cost webcasters that are paying higher rates. Second, in the same vein, insofar as webcasting cannibalizes other sources of revenues for the record companies, *e.g.*, downloads, the marginal cost associated with licensing digital performance rights to webcasters is not zero. And third, if suppliers in all channels of distribution paid only the incremental cost of licensing digital performance rights to them, record companies and artists would not receive sufficient revenues to cover their upfront investments and in the long-run the supply of music would either dry up or be vastly curtailed.

lower rate.[37] As a matter of standard economics, a licensor likely will be unwilling to offer lower rates to a higher-cost licensee unless it has the ability to price discriminate *at the level of the ultimate consumer*. SoundExchange can, of course, price discriminate between various licensees; it can offer a lower rate to one licensee without concern that another licensee will be able to take advantage of that lower rate, *i.e.*, there is little possibility of arbitrage across licensees. However, the ability to price discriminate at the level of licensee is not the only relevant focus of the analysis.[38] This is because SoundExchange is concerned about the revenues it collects on behalf of its members, and if a lower rate has the effect of shifting listener demand towards the services paying the lower rate, the result may be that the revenues collected by SoundExchange will decrease.[39]

26. There is reason to believe that lower rates for higher-cost webcasters would indeed shift some consumer demand to those services. Dr. Fratrik agrees that both terrestrial broadcasters (simulcasters) and commercial webcasters compete for listeners and advertisers.[40] Lower rates offered to certain webcasters may allow them to compete more successfully for listeners. With the benefit of a lower rate,

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[37] In this discussion, I use the term "higher-cost webcaster" as shorthand for a webcaster with relatively low profitability (gross of digital performance license fees) and thus a lower willingness to pay for digital performance rights relative to a "lower-cost webcaster," *i.e.*, one with relatively high profitability and thus a higher willingness to pay.

[38] For a technical discussion of this issue, see, Ordover, J.A. and J.C. Panzar, "On the nonlinear pricing of inputs," 23 International Econ. Rev. 659-76 (1982).

[39] Given the already large number of webcasters operating different business models and offering thousands of individual channels of music, as a general proposition it seems unlikely that offering lower rates to higher cost webcasters will substantially stimulate overall demand for music and thus overall revenues to SoundExchange. This is so for the simple reason that, given that many already existing choices, demand is likely to be stimulated only if lower rates allow a webcaster with a materially different product (service) offering to enter the market. Thus, one might hypothesize that SoundExchange could agree to a lower rate for a higher cost webcaster (or category of webcasters) only if that webcaster offered a service that for whatever reason is expected to fill an important consumer demand and stimulate (after accounting for demand diversion) net consumer demand for music beyond existing levels. Absent such meaningful product differentiation from the entrant, SoundExchange is unlikely to have any incentive to offer lower rates to higher-cost webcasters because the likely effect of such rates will be to divert demand from webcasters who pay higher rates.

[40] Hearing Transcript – Volume VI, April 27, 2010, at p. 1249.

these webcasters may be able to charge a lower subscription price than they otherwise would, enhance their service offering, or otherwise compete more effectively for listeners. Alternatively, with the benefit of a lower rate, such webcasters may simply remain in the market as a competitive alternative when they might otherwise withdraw from the market. By shifting demand away from webcasters who pay higher royalties relative to the higher-cost webcasters who receive a lower rate, the revenues collected by SoundExchange, and ultimately record companies and artists, can decline and thereby impair production of new music.[41] This suggests that SoundExchange would be unwilling to agree to a rate structure for commercial webcasters below the structure in its agreement with the NAB.

**B. Threat of Litigation**

27. Dr. Fratrik's second argument is that a desire to avoid the costs of litigation led the NAB to agree to higher rates relative to those that would obtain in the absence of a regulatory default for setting rates.[42] For reasons that I discuss below, both SoundExchange and the NAB likely have a high degree of confidence that the Judges will establish rates that are consistent with the willing buyer/willing seller construct. Accordingly, I would expect that neither party likely would be willing to incur litigation costs in the event of a disagreement insofar as the predicted outcome would be a schedule of rates to which both sides likely would have been willing to agree to in any event.

28. Dr. Fratrik further claims that the desire to avoid litigation costs is one-sided insofar as these costs are nonrecoverable by webcasters but can be funded by SoundExchange through the collection of royalties from webcasters.[43] Dr. Fratrik's

[41] Such lower revenues would have the effect of weakening incentives to create and promote musical content in the first place.

[42] Fratrik Corrected & Amended Testimony at p. 43.

[43] Id.

assertion is without merit. Webcasters collect revenues from their transmission of music to listeners and/or from the advertising revenues they earn as a function of the size of their listening audience. The fact that the source(s) of revenues for webcasters differ from the source of SoundExchange's revenues does not mean that webcasters lack the ability to fund the costs of litigation. For both sides, the payment of litigation costs is a first-order loss in income or profits.

29. Moreover, it is worth pointing out that the NAB, or any individual webcaster (or group of webcasters), need not settle in order to avoid litigation costs. The NAB simply could elect not to participate in the proceeding before the Judges. In such a case, it is my understanding that rates paid by the NAB would be established by the Judges. These rates similarly would apply to all statutory webcasters unless they are a party to a voluntary agreement with SoundExchange.[44] It does not follow that the NAB would agree to a higher-than-market rate in order to avoid litigation, when it was not compelled to litigate in any event.

### C. Sound Recording Performance Complement Waiver

30. Dr. Fratrik highlights the fact that in addition to the NAB Agreement negotiated with SoundExchange, the NAB negotiated independently with each of the four major record labels to obtain a limited waiver of the sound recording performance complement rules.[45] According to Dr. Fratrik, because the waiver has unique value to NAB members, the NAB rates reflect a higher willingness to pay relative to commercial webcasters.[46]

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[44] In the *Webcasting II* decision, for example, the Judges set rates for commercial webcasters and non-commercial webcasters, and a webcaster was required to pay whichever rate applied based on the relevant definitions.

[45] The sound recording performance complement limits the number and frequency of recordings by a given artist or from a given album that may be played within a specified time period. (Testimony of W. Tucker McCrady, September 2009, at p. 5.)

[46] Fratrik Corrected & Amended Testimony at pp. 43-44.

31. Dr. Fratrik's argument is not compelling. First, the record labels did not negotiate similar waivers of the performance complement rules with Sirius-XM, and yet the Sirius-XM Agreement stipulates nearly identical rates *vis-à-vis* the NAB rates. This suggests that the market value of the waiver is quite small. Second, even assuming that the waiver provides significant value for NAB members, it also appears to be the case that the waiver provides value to the record labels. Following the execution of the NAB Agreement and the performance complement waivers, close to 100 terrestrial broadcasters, accounting for over 300 individual stations, that had not previously been paying SoundExchange webcasting royalties began doing so. The initiation of webcasting royalty payments to SoundExchange following execution of the NAB agreement suggests that these webcasting services were launched after the NAB agreement was finalized. Thus, there is no reason to believe that inclusion of the waiver had the effect of elevating the SoundExchange-NAB rates to any material degree (if at all) above the rates the parties would have agreed to without the waiver provision.

**D. Although the NAB Agreement Rates Were Negotiated in the Shadow of Regulation, They Are Likely Reflective of Market-Based Rates**

32. In their negotiations, SoundExchange and the NAB necessarily understood that a failure to reach agreement would lead to a determination of rates by the Judges. The outcome of the negotiations between SoundExchange and the NAB, therefore, likely reflected the parties' respective predictions about what rate the Judges would set in the event that the negotiations failed, as well as the influence of marketplace considerations such as expected trends in audience size and intensity of listening. In this sense, the NAB Agreement is not a pure marketplace benchmark.

33. Nevertheless, the NAB Agreement does offer a useful corroboration of marketplace benchmarks provided that the parties believed that the Judges would set a rate in a manner that reasonably approximates what a willing buyer and willing seller would negotiate in an unregulated market, and that the parties had a

reasonable ability to understand how that standard would be applied. If these conditions are met, it is reasonable to expect that the parties' negotiated rates would fall within the range of potential outcomes that would emerge in an unregulated market.[47]

34. The reasoning underlying this conclusion is straightforward. Given that the Judges are applying a willing buyer/willing seller standard to set rates, so long as the parties have at least a reasonably clear understanding of how the Judges conduct their analysis and have confidence that the analysis will yield a rate within the range of reasonable marketplace outcomes, they will believe that any rate they negotiate that represents an acceptable marketplace outcome will also fall within the range of rates that the Judges would have set if the matter were litigated.

35. The circumstances of this case suggest it is highly plausible that the parties were of the view that they understood how the Judges would conduct their analysis and that they had confidence that the Judges' analysis would be consistent with the willing buyer/willing seller standard. That is because the parties have recent experience derived from the *Webcasting II* case. Insofar as the parties believe that the Judges successfully adhered to the willing buyer/willing seller standard in past proceedings, there is every reason to believe that they will expect the Judges to do so in the future.

36. Presumably, SoundExchange believes that the Judges accurately determined marketplace rates and correctly applied the statutory standard in *Webcasting II*, because the Judges accepted as the most appropriate evidence the market-rate benchmark presented by Dr. Michael Pelcovits, an economic expert retained by SoundExchange.[48] Based upon Dr. Pelcovits' analysis, the Judges concluded that

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[47] It is important to keep in mind that rates reached through bargaining usually fall within a range determined by market conditions and any other considerations that the parties may deem relevant.

[48] Final Rule and Order, In the Matter of Digital Performance Right In Sound Recordings And Ephemeral Recordings, Docket No. 2005-1 CRB DTRA, 72 Fed. Reg. 24084, 24092, 24095-96 (May 1, 2007). SoundExchange and Dr.

(footnote continued ...)

the benchmark he put forth "supports the explicit annual usage rates proposed by SoundExchange."[49]

37. The same is true of the broadcasters. To be sure, the broadcasters who participated in *Webcasting II* sought a significantly lower rate than what ultimately was adopted. As I already noted, bargaining mechanism can only pin down a range within which rates might fall while additional assumptions are needed to actually pin down the specific rate. However, had the rates set by the Judges in *Webcasting II* in fact fell outside (*e.g.*, exceeded) the range of reasonable rates that would have obtained in an unregulated market, one would likely observe that a number of broadcasters would have responded to those rates by exiting the webcasting market rather than paying above-market rates. That did not happen.

38. In this regard, it is important to note that under the statutory scheme, the sellers are compelled to sell at the rate set by the Judges, but the buyers are not compelled to buy.[50] And, because over-the-air broadcasting, rather than simulcasting or webcasting, is the principal business of the NAB companies, they had both the legal and practical option of simply declining to license sound recordings for digital transmission over the Internet if the rate set by the Judges exceeded what willing buyers would pay in an unregulated market.

(... footnote continued)

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Pelcovits did propose a three-part greatest-of rate structure that was rejected by the Judges in favor of using the per-performance rate that Dr. Pelcovits recommended as part of his proposed three-part structure.

[49] Id. at 24095-96.

[50] The fact that the sellers are compelled to sell under the statutory scheme but buyers are not compelled to buy suggests that, all else equal, the sellers are more likely than the buyers to want to avoid a rate-setting proceeding and may make rate concessions to avoid it. This is so because if the parties are uncertain what rate the Judges might set and consider that there is some chance that the Judges could set a rate that is lower than what a willing seller would accept in an unregulated market, the sellers have a greater incentive to avoid such an outcome because they do not have the option of declining to sell at such a low rate.

39. In fact, however, rather than a mass exit from the market, according to data obtained from SoundExchange, the NAB companies continued to license sound recording rights at the rates established in *Webcasting II.* Indeed, almost 100 broadcasters who had not previously simulcast their programming have begun doing so under the rates established in the NAB Agreement, which rates will rise during the upcoming rate term to levels above the *Webcasting II* rates.[51] This represents compelling evidence that the NAB companies, as well as SoundExchange, accepted the *Webcasting II* rates as consistent with application of the willing buyer/willing seller standard.

40. In addition, the Judges' decision in *Webcasting II* provided the parties with material guidance as to the standard and methodology that the parties could expect to be applied in *Webcasting III.* Because the parties had prior experience in these proceedings and could consult the Judges' extensive written analysis of the willing buyer/willing seller standard and its application, it is reasonable to conclude that the NAB and SoundExchange both were well-informed about the Judges' general approach to the proper application of the willing buyer/willing seller standard, and had confidence that the approach would in fact yield a rate within the range of market outcomes.

41. In my view, the foregoing discussion supports the probative value of the SoundExchange-NAB rates for purposes of determining a schedule of rates in the instant proceeding, because those parties expected that a negotiated marketplace rate would fall within the range of rates that litigation would yield.

42. To be clear, it is not my position that these recently negotiated rates should be relied upon to the exclusion of other appropriate benchmarks. However, it is my view that they should be treated by the Judges as corroborative of other

[51] In total, SoundExchange has received over 450 Notices of Election from licensees electing to have one or more channels or stations covered by the rates and terms in the NAB Agreement.

benchmark evidence in the record and probative of a reasonable schedule of rates that would obtain under hypothetical negotiations between a willing buyer and willing seller, as the Judges have defined those terms.

**E. There Is No Basis to Conclude that the SoundExchange-NAB Rates Are Elevated as a Result of an Exercise of Market Power by SoundExchange**

43. A further issue regarding the probative value of recently negotiated rates concerns the fact that these rates were negotiated collectively by the record companies under the auspices of SoundExchange, and thus may reflect, to some extent, the additional bargaining power held by SoundExchange relative to the bargaining power held by individual record companies. In other words, the concern might be that the negotiated rates include a premium attributable to the hypothesized incremental bargaining advantage in the hands of SoundExchange. While this concern may be valid under certain market conditions, it is also the case that economic theory actually predicts the opposite outcome under certain relevant market conditions, *i.e.*, there are plausible conditions under which the rate negotiated by SoundExchange would be lower than the average rate that would obtain if record companies negotiated individually.

44. In order to assess the consequences of SoundExchange's operation as the negotiating entity on the NAB-SoundExchange rates it is important to ask if it effectively operates as a cartel. By this I mean whether SoundExchange replaces the record labels in the sense that they can no longer negotiate individually. If the answer is yes, then concerns regarding SoundExchange's bargaining power (relative to an individual label) plausibly warrant examination. Alternatively, if SoundExchange properly is viewed as another licensor of digital performance rights, *i.e.*, in addition to the individual record labels, then concerns regarding SoundExchange's bargaining power likely are at least mitigated.

45. It is my understanding that SoundExchange, under the law, is permitted to negotiate the statutory webcasting rates only on a non-exclusive basis. That is, SoundExchange does not replace the record companies but rather operates as an

additional seller through which the record companies have the opportunity, but not the obligation, to bargain collectively. The testimony presented by Live365 offers no evidence that SoundExchange did, in fact, act as a cartel, and I am not otherwise aware of any evidence that SoundExchange effectively acts as a cartel.

46. Moreover, it should be pointed out that the NAB may also enjoy some degree of added bargaining power relative to that held by individual broadcasters precisely because it negotiates on behalf of a large group of buyers. According to data from SoundExchange, the broadcasters on whose behalf the NAB negotiated accounted for over 50% of the royalty revenues received by SoundExchange from webcasters in 2008, the last full year prior to the negotiation of the NAB Agreement. Such added market power on the buyer side tends to mitigate, if not fully offset, additional leverage that SoundExchange might bring to the negotiations.

47. Finally, if SoundExchange indeed functioned as a cartel, its ability to extract above-market rates in a negotiation with the NAB would be limited to some degree by the existence of the regulatory process. At some point, buyers such as the NAB members would simply elect to seek rates established by the Judges – which would be free of any potential cartel effects – rather than voluntarily agree to pay above-market rates.

48. Accordingly, I do not assume that SoundExchange functions as a cartel, or that if it did so, its market power would not be mitigated by corresponding market power resulting from the buyers acting through a single entity, or by the existence of a regulatory rate-setting mechanism. Nevertheless, in the analysis that follows, I will show that SoundExchange, acting as a single seller in an unregulated market, might well agree to lower royalty rates compared to the average of the rates that would emerge in a market in which individual record companies function as sellers.

49. The directional effect of the record companies negotiating as a single entity under the auspices of SoundExchange depends partially on the assumption one makes about whether a webcaster requires access to the repertoires of all four major

record companies in order to operate an economically viable business, or only to a subset. If one assumes that the catalogs of all four majors are needed,[52] then economic theory predicts that a rate negotiated with SoundExchange can actually be *lower* than the average rate that would be reached through individual negotiations.[53]

50. I have undertaken no independent assessment regarding the validity of this assumption with respect to all webcasters. If it were the case that the catalogs of all four majors were not needed to operate an economically viable service, then the effect of the four majors negotiating as a collective unit under the auspices of SoundExchange, as compared to individual negotiations, could go either way depending upon several factors, including the minimum number of major record company catalogs required and the incremental value to the distribution service from adding each additional catalog.

51. In this context, it is important to note that the webcasters on whose behalf NAB negotiated a deal with SoundExchange are predominantly simulcasters, *i.e.*, entities that offer terrestrial broadcasts of their programming and simultaneously transmit that same programming on the Internet. The core business of these entities is the terrestrial broadcast of programming, and for their terrestrial broadcasts these companies are not required to pay a sound recording royalty. In order to maximize listener volumes and hence advertising revenues, one would expect these entities to include in their terrestrial programming sound recordings from the catalogs of all four major record companies and at least some independent record companies. This is especially the case given that a

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[52] *See, e.g.*, In the Matter of Digital Performance Right In Sound Recordings And Ephemeral Recordings, Docket No. 2005-1 CRB DTRA, Hearing Transcript - Volume 22, June 21, 2006, at pp 313-15 (Robert Roback testifying that "to offer the most competitive and compelling product you need the entire catalogue for your radio offering").

[53] The average rate is best understood as the sum of the rates paid to all holders of the relevant copyrights, with each rate scaled (weighted) according to the fraction of total music played from each copyright holder.

performance rights license is not required for the terrestrial broadcast of sound recordings. Having programmed their terrestrial broadcasts to include sound recordings from all of the major record companies, however, the failure to obtain licenses from all of the majors in connection with their webcasting services would, by definition, eliminate the ability to simulcast. Because they cannot re-broadcast their terrestrial signal over the Internet without access to the catalogs of the four majors, economic theory would predict that the rates voluntarily negotiated between SoundExchange and the NAB are actually lower than the rates that would obtain through negotiations between a single NAB member and one of the four major labels, *i.e.*, through arms-length bargaining between a willing buyer and a willing seller.[54]

52. Support for this outcome comes from the economic literature on royalty stacking, which refers to situations wherein a downstream firm requires licenses to multiple upstream patents in order to sell lawfully its product in the marketplace.[55] In such a setting, failure to strike a deal with every relevant patent-holder precludes the supplier from operating its business. Royalty stacking is an extreme version of the situation facing simulcasters, and perhaps webcasters more generally, insofar as they require licenses to the digital performance rights pertaining to the music content of all four major record companies in order to operate an economically viable service.

53. More specifically, under the condition that webcasters require licenses from all major record companies, a setting in which multiple record companies negotiate their licenses separately rather than cooperatively is expected to increase the

[54] The points made in this paragraph apply with equal force to Sirius-XM, whose webcasting operations consist of simulcasting the company's core satellite radio transmissions and thus require access to the catalogs of the four majors plus numerous independent labels.

[55] *See, e.g.*, Lemley, M.A. and C. Shapiro, "Patent Holdup and Royalty Stacking," 85 *Texas Law Review*, at p. 2010 (2007) for a non-technical exposition.

average royalty rate paid by downstream webcasters. The reason is that individual negotiations give rise to a well-known pricing issue commonly referred to by economists as *Cournot-complements*. As a result, the overall demand for music would tend to decline and also the overall revenues from music licensing. Thus, under some conditions, individualized licensing is a "loss-loss" proposition for all the stakeholders. Below and in Appendix Two, I explain this effect in more detail.

54. The revenue earned by each record company can be calculated as the royalty rate charged by the record company multiplied by the total quantity sold to consumers (in the instant case the number of performances). A higher royalty rate charged by a record company increases the marginal costs incurred by each webcaster. Because webcasters pass on to downstream consumers at least some portion of the increase in marginal costs in the form of higher prices, the result of a higher royalty rate charged by any record company is decreased demand for the webcaster's service by downstream consumers, and hence for music. In turn, this decreased demand negatively affects the revenues earned by *all* record companies, not just the company charging a higher royalty rate.

55. Stated differently, when a record company charges a higher royalty rate it imposes an externality on all other record companies because each and every record company is impacted adversely by the resulting lower demand for the webcaster's service. However, an individual record company only takes into account the adverse effect of lower demand on its own revenues, ignoring the effect that its decision imposes on the revenues of the other record companies. This failure to account for the full effect of reduced demand weakens the constraint faced by an individual firm when it contemplates an increase to its royalty rate.[56]

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[56] Importantly, this same dynamic can operate in situations involving webcasters that provide ad-supported (free) services to consumers. While higher royalty rates should not lead to higher subscription fees (because the services are designed to be free to listeners), the services could adopt other measures to account for increases in marginal cost due to hypothesized higher royalty payments. In particular, the services could respond to higher royalty rates

(footnote continued ...)

56. In contrast, under a scenario in which a single firm (SoundExchange) effectively controls all pertinent copyrights, the firm will set a royalty rate that fully accounts for the effect of that rate on the downstream supplier's output, *i.e.*, the firm will internalize the full effect that a higher royalty has on market demand. Such internalization tightens the constraint faced by the firm when it considers raising its royalty, which results in lower rates compared to individually-negotiated rates.

57. Appendix Two presents a numerical example that illustrates this idea. Moreover, the Appendix illustrates a well-known result that the more independent licensors there are, the lower is the royalty rate applied to the whole repertoire as a result of collective negotiations *vis-à-vis* the rates that would emerge through individual negotiations.

58. Thus, insofar as there are concerns about SoundExchange's market power and how the exercise of that market power might lead to higher negotiated rates, economic theory predicts that rates negotiated by SoundExchange can, in fact, be lower relative to the average of individually negotiated rates at least under a scenario that assumes each webcaster requires access to the catalogs of all four major record companies in order to remain economically viable.

## V. Conclusion

59. For the reasons detailed above, I conclude that there is no sound economic basis for the Judges to adopt the analysis and recommended rate presented by Dr. Fratrik and Live365. The assumptions at the core of his financial modeling are unsupported and indefensible. Furthermore, contrary to Dr. Fratrik, I believe that

(... footnote continued)

by placing caps on listening time, which would reduce the volume of royalty-bearing performances, and hence royalty payments. It is my understanding that Live365 has implemented caps on listening time for this very purpose. (Lam Deposition, at pp. 42-44.) An ad-supported service could also attempt to run more advertising in order to defray the increase in marginal costs arising from higher royalty rates. Insofar as a webcaster undertook any measure that degraded the overall quality of the service, demand for the service would be expected to decline.

economic theory supports the use of the negotiated rates in the NAB Agreement as probative evidence of rates that would occur under the willing buyer/willing seller statutory standard.

I declare under penalty of perjury that the foregoing testimony is true and correct.

Date: June 7, 2010

Janusz A. Ordover

# Appendix One

May 2010


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## EDUCATION

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| 1968-1973 | Columbia University, New York, New York<br>Graduate Department of Economics and European Institute of the School of International Affairs<br>Doctoral Dissertation: Three Essays on Economic Theory (May 1973). Ph.D 1973. |
| 1967-1968 | McGill University, Montreal, Canada<br>Departments of Economics and Political Science |
| 1963-1966 | Warsaw University, Warsaw, Poland<br>Department of Political Economy. B.A. (equiv.), 1966. |

## HONORS

| | |
|---|---|
| 1973 | Columbia University: Highest distinction for the doctoral dissertation |
| 1971-1972 | Columbia University: Honorary President's Fellow |
| 1969-1971 | Columbia University: President's Fellow |
| 1967-1968 | McGill University: Honors Student |
| 1964, 1965 | Warsaw University: Award for Academic Achievement, Department of Political Economy |
| | Who's Who in the World<br>Who's Who in America<br>Who's Who in the East |

## PROFESSIONAL EXPERIENCE

| | |
|---|---|
| June 1982 - present | Professor of Economics<br>Department of Economics, New York University, New York, New York |
| Sept. 1996 - Aug. 2001 | Director of Masters in Economics Program<br>Department of Economics, New York University, New York, New York |

| | |
|---|---|
| Summer 1996-<br>2000 | Lecturer<br>International Program on Privatization and Reform<br>Institute for International Development, Harvard University, Cambridge, Massachusetts |
| Aug. 1991 -<br>Oct. 1992 | Deputy Assistant Attorney General for Economics<br>Antitrust Division<br>United States Department of Justice, Washington, D.C. |
| Sept. 1989 -<br>July 1990 | Visiting Professor of Economics<br>School of Management, Yale University, New Haven, Connecticut |
| | Lecturer in Law<br>Yale Law School |
| Mar. 1984 -<br>June 1988 | Visiting Professor of Economics<br>Universita Commerciale "Luigi Bocconi", Milan, Italy |
| June 1982 -<br>Feb. 1985 | Director of Graduate Studies<br>Department of Economics, New York University |
| Sept. 1982 -<br>June 1986 | Adjunct Professor of Law (part-time)<br>Columbia University Law School, New York, New York |
| Feb. 1982 -<br>June 1982 | Acting Director of Graduate Studies<br>Department of Economics, New York University |
| June 1978 -<br>June 1982 | Associate Professor of Economics<br>Department of Economics, New York University |
| Sept. 1979 -<br>May 1990 | Lecturer in Economics and Antitrust<br>New York University Law School |
| Sept. 1977 -<br>June 1978 | Member, Technical Staff<br>Bell Laboratories, Holmdel, New Jersey |
| | Associate Professor of Economics<br>Columbia University |
| | Visiting Research Scholar<br>Center for Law and Economics, University of Miami, Miami, Florida |
| Sept. 1973 -<br>Aug. 1977 | Assistant Professor of Economics<br>New York University |
| Summer 1976 | Fellow, Legal Institute for Economists,<br>Center for Law and Economics, University of Miami |
| Summer 1976 | Visiting Researcher Bell Laboratories, Holmdel, New Jersey |

## OTHER PROFESSIONAL ACTIVITIES

| | |
|---|---|
| 2006 - present | Special Consultant, Compass Lexecon (formerly Compass)/FTI Company, Washington, D.C. |
| 2003 - 2006 | Director, Competition Policy Associates, Inc. ("Compass"), Washington, D.C. |
| 1997 – 1999 | Consultant, Inter-American Development Bank, Washington, D.C. |
| 1997 – present | Board of Editors, *Antitrust Report* |
| 1995 – 2001 | Consultant, The World Bank, Washington, D.C. |
| 1998 – 2004 | Senior Consultant<br>Applied Economic Solutions, Inc., San Francisco, California |
| 1995 - 2000 | Senior Affiliate<br>Cornerstone Research, Inc., Palo Alto, California |
| various | Testimony at Hearings of the Federal Trade Commission |
| 1994 - 1996 | Senior Affiliate<br>Law and Economics Consulting Group, Emoryville, California |
| 1994 - 2000 | Senior Affiliate<br>Consultants in Industry Economics, LLC, Princeton, New Jersey |
| 1993 - 1994 | Director<br>Consultants in Industry Economics, Inc., Princeton, New Jersey |
| 1992 - 1993 | Vice-Chair (*pro tempore*)<br>Economics Committee, American Bar Association, Chicago, Illinois |
| 1990 - 1991<br>1992 - 1995 | Senior Consultant<br>Organization for Economic Cooperation and Development, Paris, France |
| 1991 | Member<br>*Ad hoc* Working Group on Bulgaria's Draft Antitrust Law<br>The Central and East European Law Initiative<br>American Bar Association |
| 1990 - 1991 | Advisor<br>Polish Ministry of Finance and Anti-Monopoly Office<br>Warsaw, Poland |
| 1990 - 1991 | Member<br>Special Committee on Antitrust<br>Section of Antitrust Law, American Bar Association |
| 1990 - 1991 | Director and Senior Advisor<br>Putnam, Hayes & Bartlett, Inc., Washington, D.C. |
| 1990 - 1996 | Member<br>Predatory Pricing Monograph Task Force<br>Section of Antitrust Law, American Bar Association |

| | |
|---|---|
| 1989 | Hearings on Competitive Issues in the Cable TV Industry<br>Subcommittee on Monopolies and Business Rights of the Senate Judiciary Committee<br>Washington, D.C. |
| 1989 | Member<br>EEC Merger Control Task Force, American Bar Association |
| 1988 - present | Associate Member<br>American Bar Association |
| 1987 - 1989 | Adjunct Member<br>Antitrust and Trade Regulation Committee, The Association of the Bar of the City of New York |
| 1984 | Speaker, "Industrial and Intellectual Property: The Antitrust Interface"<br>National Institutes, American Bar Association, Philadelphia, Pennsylvania |
| 1983 - 1990 | Director<br>Consultants in Industry Economics, Inc |
| 1982 | Member<br>Organizing Committee<br>Tenth Annual Telecommunications Policy Research Conference, Annapolis, Maryland |
| 1981 | Member<br>Section 7 Clayton Act Committee, Project on Revising Merger Guidelines<br>American Bar Association |
| 1980 | Organizer<br>Invited Session on Law and Economics<br>American Economic Association Meetings, Denver, Colorado |
| 1978 - 1979 | Member<br>Department of Commerce Technical Advisory Board<br>Scientific and Technical Information Economics and Pricing Subgroup |
| 1978 – present | Referee for numerous scholarly journals, publishers, and the National Science Foundation |

## MEMBERSHIPS IN PROFESSIONAL SOCIETIES

American Economic Association
American Bar Association

## PUBLICATIONS

### A. Journal Articles

"Coordinated Effects in Merger Analysis: An Introduction," *Columbia Bus. Law Review*, No. 2, 2007, 411-36.

"Wholesale access in multi-firm markets: When is it profitable to supply a competitor?" with Greg Shaffer, *International Journal of Industrial Organization*, vol. 25 (5), October 2007, 1026-45.

"Merchant Benefits and Public Policy towards Interchange: An Economic Assessment," with M. Guerin-Calvert, *Review of Network Economics: Special Issue*, vol. 4 (4), December 2005, 381-414.

"All-Units Discounts in Retail Contracts," with S. Kolay and G. Shaffer, *J. of Economics and Management Strategy*, vol. 13 (3), September 2004, 429-59.

"Archimedean Leveraging and the GE/Honeywell Transaction," with R. J. Reynolds, *Antitrust Law Journal*, vol. 70, no. 1, 2002, 171-98.

"Entrepreneurship, Access Policy and Economic Development: Lessons from Industrial Organizations," with M. A. Dutz and R. D. Willig, *European Economic Review*, vol. 4, no. 4-6, May 2000.

"Parity Pricing and its Critics: Necessary Condition for Efficiency in Provision of Bottleneck Services to Competitors," with W. J. Baumol and R .D. Willig, *Yale Journal on Regulation*, vol. 14, Winter 1997, 146-63.

"Competition and Trade Law and the Case for a Modest Linkage," with E. Fox, *World Competition, Law and Economics Review*, vol. 19, December 1995, 5-34.

"On the Perils of Vertical Control by a Partial Owner of Downstream Enterprise," with W.J. Baumol, *Revue D'économie industrielle*, No. 69, 3$^{e}$ trimestre 1994, 7-20.

"Competition Policy for Natural Monopolies in Developing Market Economy," with R.W. Pittman and P. Clyde, *Economics of Transition*, vol. 2, no. 3, September 1994, 317-343. Reprinted in B. Clay (ed), *De-monopolization and Competition Policy in Post-Communist Economies*, Westview Press 1996, 159-193.

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"Entry Analysis Under the 1992 Horizontal Merger Guidelines," with Jonathan B. Baker, *Antitrust Law Journal*, vol. 61, no. 1, Summer 1992, 139-146.

"Economics and the 1992 Merger Guidelines: A Brief Survey," with Robert D. Willig, *Review of Industrial Organization*, vol. 8, 139-150, 1993. Reprinted in E. Fox and J. Halverson (eds.), *Collaborations Among Competitors: Antitrust Policy and Economics*, American Bar Association, 1992, 639-652.

"Equilibrium Vertical Foreclosure: A Reply," with G. Saloner and S.C. Salop, *American Economic Review*, vol. 82, no. 3, 1992, 698-703.

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"R&D Cooperation and Competition," with M. Katz, *Brookings Papers on Economic Activity: Microeconomics*, 1990, 137-203.

"Equilibrium Vertical Foreclosure," with G. Saloner and S. Salop, *American Economic Review*, vol. 80, March 1990, 127-142.

"Antitrust Policy for High-Technology Industries," with W.J. Baumol, *Oxford Review of Economic Policy*, vol. 4, Winter 1988, 13-34. Reprinted in E. Fox and J. Halverson (eds.), *Collaborations Among Competitors: Antitrust Policy and Economics*, American Bar Association, 1991, 949-984.

"Conflicts of Jurisdiction: Antitrust and Industrial Policy," *Law and Contemporary Problems*, vol. 50, Summer 1987, 165-178.

"Market Structure and Optimal Management Organization," with C. Bull, *Rand Journal of Economics*, vol. 18, no. 4, Winter 1987, 480-491.

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"Use of Antitrust to Subvert Competition," with W.J. Baumol, *Journal of Law and Economics*, vol. 28, May 1985, 247-266. Reprinted in *Journal of Reprints for Antitrust Law and Economics*, vol. 16, no. 2.

"Advances in Supervision Technology and Economic Welfare: A General Equilibrium Analysis," with C. Shapiro, *Journal of Public Economics*, vol. 25/3, 1985, 371-390.

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"On Non-linear Pricing of Inputs," with J. Panzar, *International Economic Review*, October 1982, 659-675.

"Herfindahl Concentration, Rivalry and Mergers," with A. O. Sykes and R. D. Willig, *Harvard Law Review*, vol. 95, June 1982, 1857-1875.

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"An Economic Definition of Predation: Pricing and Product Innovation," with R.D. Willig, *Yale Law Journal*, vol. 91, November 1981, 8-53.

"On the Consequences of Costly Litigation in the Model of Single Activity Accidents: Some New Results," *Journal of Legal Studies*, June 1981, 269-291.

"On the Political Sustainability of Taxes," with A. Schotter, *American Economic Review Papers and Proceedings*, May 1981, 278-282.

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"On the Nonexistence of *Pareto Superior* Outlay Schedules," with J. Panzar, *The Bell Journal of Economics*, Spring 1980, 351-354.

"The Role of Information in the Design of Public Policy Towards Externalities," with R. D. Willig, *Journal of Public Economics*, December 1979, 271-299.

"On the Concept of Optimal Taxation in the Overlapping-Generations Model of Efficient Growth," with E.S. Phelps, *Journal of Public Economics*, August 1979, 1-27.

"Products Liability in Markets With Heterogeneous Consumers," *Journal of Legal Studies*, June 1979, 505-525.

"Costly Litigation and the Tort Law: Single Activity Accidents," *Journal of Legal Studies*, June 1978, 243-261.

"On the Optimal Provision of Journals Qua Excludable Public Goods," with R. D. Willig, *American Economic Review*, June 1978, 324-338.

"Distortionary Wage Differentials in a Two-Sector Growth Model: Some Theorems on Factor Earnings," *International Economic Review*, June 1978, 321-333.

"On the Optimality of Public-Goods Pricing with Exclusion Devices," with W.J. Baumol, *Kyklos*, Fasc. 1, 1977, 5-21.

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"Distributive Justice and Optimal Taxation of Wages and Interest in a Growing Economy," *Journal of Public Economics*, January 1976, 139-160.

"Linear Taxation of Wealth and Wages for Intragenerational Lifetime Justice: Some Steady-State Cases," with E.S. Phelps, *American Economic Review*, September 1975, 660-673.

**B. Books and Monographs**

*Proceedings of the Tenth Annual Telecommunications Policy Research Conference*, editor with O. Gandy and P. Espinosa, ABLEX Publishers, 1983.

*Obstacles to Trade and Competition*, with L. Goldberg, OECD, Paris, 1993.

*Predatory Pricing*, with William Green, *et al.*, American Bar Association, Section of Antitrust Law, Monograph 22, 1996.

**C. Book Chapters**

"Coordinated Effects," chap. 27, in *Issues in Competition Law and Policy*, vol. 2, American Bar Association, 2008, 1359-1384.

"Practical Rules for Pricing Access in Telecommunications," with R. D. Willig, Chap. 6, in *Second-Generations Reforms in Infrastructure Services,* F. Besanes and R. D. Willig (eds.), Inter-American Development Bank, Washington, D.C., April 2002, 149-76.

"Sustainable Privatization of Latin American Infrastructure: The Role of Law and Regulatory Institutions," with Evamaria Uribe, Chap. 1 in F. Basanes, E. Uribe, R. D. Willig (eds.), *Can Privatization Deliver? Infrastructure for Latin America,* The Johns Hopkins U. P. for Inter-American Development Bank, 1999, 9-32.

"Access and Bundling in High-Technology Markets," with R. D. Willig, Chap. 6, in J. A. Eisenach and T. M. Leonard, (eds.), *Competition, Innovation, and the Microsoft Monopoly: The Role of Antitrust in the Digital Marketplace*, Kluver Academic Press, 1999, 103-29.

"The Harmonization of Competition and Trade Law," with E. Fox, Chap. 15 in L. Waverman, *et al.* (eds.), *Competition Policy in the Global Economy*, Routledge, 1997, 407-439.

"Transition to a Market Economy: Some Industrial Organization Issues," with M. Iwanek, Chap. 7 in H. Kierzkowski, *et al.* (eds.), *Stabilization and Structural Adjustment in Poland*, Routledge, 1993, 133-170.

"Competition Policies for Natural Monopolies in a Developing Market Economy," with Russell Pittman, *Butterworth's Trade and Finance in Central and Eastern Europe*, Butterworth Law Publishers Ltd., 1993, 78-88, Reprinted in *Journal for Shareholders* (published by the Russian Union of Shareholder), Moscow, January 1993, 33-36; *Versenyfelugyeleti Ertesito* (Bulletin of Competition Supervision), Budapest, vol. 3, no. 1-2, January 1993, 30-41; *Narodni Hospodarstvi* (National Economy), Prague; *ICE: Revista de Economia*, No. 736 (December 1994) (in Spanish), 69-90.

"Antitrust: Source of Dynamic and Static Inefficiencies?" with W.J. Baumol, in T. Jorde and D. Teece (eds.), *Antitrust, Innovation, and Competitiveness*, Oxford University Press, 1992, 82-97. Reprinted in "The Journal of Reprints for Antitrust Law and Economics," vol. 26, no. 1, 1996.

"Economic Foundations of Competition Policy: A Review of Recent Contributions," in W. Comanor, et al., *Competition Policy in Europe and North America: Economic Issues and Institutions, Fundamentals of Pure and Applied Economics* (Vol. 43), Harwood Academic Publishers, 1990, 7-42.

"The Department of Justice 1988 Guidelines for International Operations: An Economic Assessment," with A.O. Sykes, in B. Hawk (ed.), *European/American Antitrust and Trade Laws*, Matthew Bender, 1989, 4.1-4.18.

"Predation, Monopolization, and Antitrust," with G. Saloner, in R. Schmalensee and R.D. Willig (eds.), *Handbook of Industrial Organization*, vol. 1, North Holland, 1989, 538-596.

"Supervision Technology, Firm Structure, and Employees' Welfare," in *Prices, Competition and Equilibrium*, M. Peston and R.E. Quandt (eds.), Philip Allan Publishers, Ltd., 1986, 142-163.

"Perspectives on Mergers and World Competition," with R.D. Willig, in *Antitrust and Regulation*, R. Grieson (ed.), Lexington Books, 1986, 201-218.

"Transnational Antitrust and Economics," in *Antitrust and Trade Policies in International Trade*, B. Hawk (ed.), Matthew Bender, 1985, 233-248.

"Pricing of Interexchange Access: Some Thoughts on the Third Report and Order in FCC Docket No. 78-72," in *Proceedings of the Eleventh Annual Telecommunications Policy Research Conference*, Vincent Mosco (ed.), ABLEX Publishers, 1984, 145-161.

"Non-Price Anticompetitive Behavior by Dominant Firms Toward the Producers of Complementary Products," with A.O. Sykes and R.D. Willig, in *Antitrust and Regulation: Essays in Memory of John McGowan*, F. Fisher (ed.), MIT Press, 1985, 315-330.

"Local Telephone Pricing in a Competitive Environment," with R.D. Willig, in *Regulating New Telecommunication Networks*, E. Noam (ed.), Harcourt Brace Jovanovich, 1983, 267-289.

"An Economic Definition of Predatory Product Innovation," with R.D. Willig, in *Strategy, Predation and Antitrust Analysis*, S. Salop (ed.), Federal Trade Commission, 1981, 301-396.

"Marginal Cost," in *Encyclopedia of Economics*, D. Greenwald (ed.), McGraw-Hill, 2nd ed. 1994, 627-630.

"Understanding Economic Justice: Some Recent Development in Pure and Applied Welfare Economics," in *Economic Perspectives*, M. Ballabon (ed.) Harwood Academic Publishers, vol. 1, 1979, 51-72.

"Problems of Political Equilibrium in the Soviet Proposals for a European Security Conference," in *Columbia Essays in International Affairs*, Andrew W. Cordier (ed.) Columbia University Press, New York, 1971, 1951-197

**D. Other Publications**

"The Economics of Price Discrimination," with Doug Fontaine and Greg Shaffer, in *The Economics of the Internet, The Vodafone Policy Paper Series,* No. 11, April 11, 2010, 27-51.

"How Loyalty Discounts Can Perversely Discourage Discounting: Comment," with Assaf Eilat, et al, *The CPI Antitrust Journal*, April 2010 (1).

"Economic Analysis in Antitrust Class Certification: *Hydrogen Peroxide*," with Paul Godek, *Antitrust Magazine*, vol. 24, No. 1, Fall 2009, pp. 62-65.

"Comments on Evans & Schmalensee's 'The Industrial Organization of Markets with Two-Sided Platforms', *Competition Policy International,* vol. 3(1), Spring 2007, 181-90.

"Safer Than A Known Way? A Critique of the FTC's Report on Competition and Patent Law and Policy," with I. Simmons and D. A. Applebaum, *Antitrust Magazine,* Spring 2004, 39-43.

"Predatory Pricing," in Peter Newman (ed.), *The New Palgrave Dictionary of Economics and the Law*, Grove Dictionaries, New York, 1999. Revised in *The New Palgrave Dictionary of Economics, 2nd edition,* S. Durlauf and L. Blume (editors) (forthcoming 2007).

Book review of L. Phlips, *Competition Policy: A Game Theoretic Perspective*, reviewed in *Journal of Economic Literature*, vol. 35, No.3, September 1997, 1408-9.

"The Role of Efficiencies in Merger Assessment: The 1997 Guidelines," *Antitrust Report*, September 1997, 10-17.

"Bingaman's Antitrust Era," *Regulation*, vol. 20, No. 2, Spring 1997, 21-26.

"Competition Policy for High-Technology Industries," *International Business Lawyer*, vol. 24, No. 10, November 1996, 479-82.

"Internationalizing Competition Law to Limit Parochial State and Private Action: Moving Towards the Vision of World Welfare," with E.M. Fox, *International Business Lawyer*, vol. 24, No. 10, November 1996, 458-62.

"Economists' View: The Department of Justice Draft for the Licensing and Acquisition of Intellectual Property," *Antitrust*, vol. 9, No. 2, Spring 1995, 29-36.

"Competition Policy During Transformation to a Centrally Planned Economy: A Comment," with R.W. Pittman, in B. Hawk (ed.), *1992 Fordham Corporate Law Institute*, 533-38.

"Poland: The First 1,000 Days and Beyond," *Economic Times*, vol. 3, no. 9, October 1992, 6-7.

"Interview: Janusz A. Ordover: A Merger of Standards? The 1992 Merger Guidelines," *Antitrust,* vol. 6, no. 3, Summer 1992, 12-16.

"Interview: U.S. Justice Department's New Chief Economist: Janusz A. Ordover," *International Merger Law*, no. 14, October 1991.

"Poland: Economy in Transition," *Business Economics*, vol. 26, no. 1, January 1991, 25-30.

"Economic Analysis of Section 337: Protectionism versus Protection of Intellectual Property," with R.D. Willig, in *Technology, Trade and World Competition*, JEIDA Conference Proceedings, Washington, D.C., 1990, 199-232.

"Eastern Europe Needs Antitrust Now," with E. Fox, *New York Law Journal*, November 23, 1990, 1-4.

"Understanding Econometric Methods of Market Definition," with D. Wall, *Antitrust*, vol. 3, no. 3, Summer 1989, 20-25.

"Proving Entry Barriers: A Practical Guide to Economics of Entry," with D. Wall, *Antitrust*, vol. 2, no. 2, Winter 1988, 12-17.

"Proving Predation After Monfort and Matsushita: What the New 'New Learning' has to Offer," with D. Wall, *Antitrust*, vol. 1, no. 3, Summer 1987, 5-11.

"The Costs of the Tort System," with A. Schotter, Economic Policy Paper No. PP-42, New York University, March 1986. Reprinted in *Congressional Record*, U.S. Government Printing Office, Washington, D.C., 1987.

"An Economic Definition of Predation: Pricing and Product Innovation," with R.D. Willig, Report for the Federal Trade Commission, October 1982, 131 pp.

"Market Power and Market Definition," with R.D. Willig, Memorandum for ABA Section 7 Clayton Act Committee, Project on Revising the Merger Guidelines, May 1981.

"Herfindahl Concentration Index," with R.D. Willig, Memorandum for ABA Section 7 Clayton Act Committee, Project on Revising the Merger Guidelines, March 1981.

"Public Interest Pricing of Scientific and Technical Information," Report for the Department of Commerce Technical Advisory Board, September 1979.

"Economics of Property Rights as Applied to Computer Software and Databases," with Y.M. Braunstein, D.M. Fischer, W.J. Baumol, prepared for the National Commission on New Technological Uses of Copyrighted Works, June 1977, 140 pp. Reprinted in part in *Technology and Copyright*, R.H. Dreyfuss (ed.), Lemond Publications, 1978.

Book review of O. Morgenstern and G.L. Thompson, *Economic Theory of Expanding and Contracting Economies*, reviewed in *Southern Economic Journal*, September 1978.

"Manual of Pricing and Cost Determination for Organizations Engaged in Dissemination of Knowledge," with W.J. Baumol, Y.M. Braunstein, D.M. Fischer, prepared for the Division of Science Information, NSF April 1977, 150 pp.

**UNPUBLISHED PAPERS**

"Exclusionary Discounts," with Greg Shaffer, August 2006.

"Regulation of Credit Card Interchange Fees and Incentives for Network Investments," with Y. Wang, Competition Policy Associates WP, Washington D.C. September 2005.

"Economics, Antitrust and the Motion Picture Industry," C.V. Starr Center Policy Paper, July 1983.

"On Bargaining, Settling, and Litigating: A Problem in Multiperiod Games With Imperfect Information," with A. Rubinstein, C.V. Starr Working Paper, December 1982.

"Supervision and Social Welfare: An Expository Example," C.V. Starr Center Working Paper, January 1982.

"Should We Take Rights Seriously: Economic Analysis of the Family Education Rights Act," with M. Manove, November 1977.

"An Echo or a Choice: Product Variety Under Monopolistic Competition," with A. Weiss; presented at the Bell Laboratories Conference on Market Structures, February 1977.

## GRANTS RECEIVED

Regulation and Policy Analysis Program, National Science Foundation, Collaborative Research on Antitrust Policy, Principal Investigator, July 15, 1985 - December 31, 1986.

Regulation of Economic Activity Program, National Science Foundation, Microeconomic Analysis of Antitrust Policy, Principal Investigator, April 1, 1983 - March 31, 1984.

Economics Division of the National Science Foundation, "Political Economy of Taxation," Principal Investigator, Summer 1982.

Sloan Workshop in Applied Microeconomics (coordinator), with W.J. Baumol (Principal Coordinator), September 1977 - August 1982.

Economics Division of the National Science Foundation, "Collaborative Research on the Theory of Optimal Taxation and Tax Reform," July 1979 to September 1980, with E.S. Phelps.

Division of Science Information of the National Science Foundation for Research on "Scale Economies and Public Goods Properties of Information," W.J. Baumol, Y.M. Braunstein, M.I. Nadiri, Fall 1974 to Fall 1977.

National Science Foundation Institutional Grant to New York University for Research on Taxation and Distribution of Income, Summer 1974.

## Expert Testimony Provided by
## Dr. Janusz A. Ordover 2003 – 2010

*In Re: Gemstar Development Corporation Patent Litigation*, MDL-1274-WBH (N.D. Ga.) (deposition testimony)

*College Loan Corporation v. SLM Corporation, Sallie Mae, Inc., and Sallie Mae Servicing L.P.*, Civil Action No. 02-1377A (E.D. Va.) (deposition testimony)

*Aventis Environmental Science et al., v. Scotts Company and Monsanto Co.*, 99 Civ. 4015 (LAP) (S.D. NY) (deposition testimony)

*The Citizenship of DHL Airways, Inc. under 49 USC 40102 (a) (15),* U.S. Department of Transportation Docket 13089 (trial testimony)

*United States of America, et al., v. First Data Corporation and Concord EFS, Inc.*, 1:03CV02169 (RMC) (pre-trial testimony, deposition testimony)

*Carolyn Fears, et al., v. Wilhelmina Model Agency, Inc., et al.*, U.S. Dist. Court, S.D.N.Y., Case No. 02-CV-4911 (HB)(HBP) (deposition testimony)

*CSC Holdings, Inc. v. Yankee Entertainment and Sports Network, LLC.*,American Arbitration Assoc. (February 2004) (deposition testimony)

*Masimo Corporation v. Tyco Health Care Group L.P. and Mallinckrodt, Incorporated*, No. CV 02-4440 MRP, (C.D. Ca.), (deposition testimony and trial testimony in 2005, deposition and trial testimony in 2006, trial testimony in 2007)

*Qantas Airways Ltd. and Air New Zealand Ltd. v. ACCC,* (The Australian Competition Tribunal, Sydney, Australia) (tribunal testimony)

*GE v. Commission*, (Case T-210/01) (The Court of First Instance, Luxembourg) (Testimony for the Commission of the European Communities) (Testimony at the Hearing for UTC In re GE/Honeywell Merger, European Commission, Brussels, Belgium)

*Sony/BMG Joint Venture* (Case No. Comp/M3333) (Oral hearing testimony at the EC, Brussels, Belgium)

*In Re: Remeron Direct Purchaser Antitrust Litigation*, Master Docket No.03-CV-85 (FSH)(New Jersey) (deposition testimony)

*Qantas Airways Ltd. and Air New Zealand Ltd. v. NZ Commerce Commission* (High Court of New Zealand, Auckland Registry Case CIV 2003 404 6590, Auckland, New Zealand) (Appeal hearing testimony)

*Reading International, Inc., et al., v. Oaktree Capital Management, et al.*, No. 03 Civ. 1895, (S.D. NY), (deposition testimony)

*Natural Gas Anti-Trust Cases I, II, III, & IV* (J.C.C.P. Nos. 4221 through 00000), Superior Court of the State of California, County of San Diego (deposition testimony)

*In Re: NCAA I-A Walk-On Football Players Litigation*, U.S. Dist. Court, Western District of Washington at Seattle, Master File No. C-04-1254-C (deposition testimony in 2005 and 2006)

*Canadian Lumber Trade Alliance, et al. v. United States, et al. and Coalition for Fair Lumber Imports Executive Committee, et al.* Consolidated Court No. 05-00324 (U.S. Court of International Trade) (deposition and trial testimony)

*Jame Fine Chemicals, Inc. v. Hi-Tech Pharma Co., Inc., v. Medpointe Inc.,* U.S. Dist. Court, Dist. of New Jersey, Civ. Action No. 00-3545 (AEI) (deposition testimony)

*Jason White, et al. v. NCAA,* U.S. Dist. Court, Central District of California, No. CV06-0999 RKG (MANx) (deposition testimony)

*In Re: Hydrogen Peroxide Antitrust Litigation,* U.S. Dist. Court, Eastern District of Pennsylvania, Civ. Action No. 05-DV-666 (MDL No.:1682) (deposition testimony)

*Rochester Medical Corp. v. C.R. Bard International et al.,* U.S. Dist. Court, E.D. of Texas (Texarkana Div.), No. 504-CV-060 (deposition testimony)

*Natchitoches Parish Hospital et al. v. Tyco International, Ltd. et al.,* U.S. Dist. Court, District of Massachusetts, Civ. Action No. 05-12024 PBS (deposition testimony twice, court hearing, jury trial testimony)

*In the Matter of Adjustment of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services,* Docket No. 20006-1 CRB DSTRA, Copyright Royalty Board, Library of Congress, Washington, D.C. (deposition testimony, hearing testimony)

*Allied Orthopedic Appliances, Inc. v. Tyco Health Care Group L.P. et al.,* U.S. Dist. Court, Central District of California (Western Div.), CV-05-6419 MRP (AJWx) (deposition testimony twice)

*Delco LLC and Edward Decker v. Giant of Maryland LLC, Wakefern Food Corp., and Stop & Shop Supermarket Company LLC,* U.S. Dist. Court, District of New Jersey (Camden Vicinage), No. 07-CV-03522 (JBS-AMD) (deposition and PI hearing testimony)

*Woolworths Ltd. and The Warehouse Group v. The Commerce Commission,* High Court of New Zealand, Wellington Registry, CIV 2007-485-1255 (hearing on the appeal from the determination of the NZ Commerce Commission)

*IGT v. Alliance Gaming et al.,* U.S. Dist. Court, Dist. of Nevada, No. CV-S-04 (1676-RCJ-(RJJ)) (deposition testimony)

*In Re: New Motor Vehicle Canadian Export Antitrust Litigation,* MDL Docket No. 03-md-1532-P-H (All Cases) (deposition testimony)

*The European Commission Case Comp. 39.188 Bananas,* European Commission, Brussels, Belgium (Oral Hearing testimony)

*The European Commission Case Comp. 37.990 Intel,* European Commission, Brussels, Belgium (Oral Hearing testimony)

*Appeal No. 25: PCCW versus Telecommunications Authority,* In the Telecommunications (Competition Provisions) Appeal Board, Hong Kong (Testimony)

*Michael Siegel et al., v. Shell Oil Co., et al.,* U.S. District Court, Northern District of Illinois, Eastern Div., No. 06 C 0035 (deposition testimony)

*The Commerce Commission v. Telecom Corp. of New Zealand Ltd.,* High Court of New Zealand, Auckland Registry, Civ. 2004-404-1333 ("hot tub" testimony)

*Daniels Shapsmart Inc., Plaintiff, v. Tyco International, (US) Inc., and Tyco Healthcare Group, L.P., Defendants,* U.S. District Court, Eastern District of Texas, Texarkana Division, No. 5:05-CV-169 (deposition testimony)

*FTC v. CCC Holdings, Inc., et al,* U.S. District Court for the District of Columbia, CA 08-2043 (deposition and trial testimony)

*Rambus Inc. v. Micron Technology, Inc. et al.,* Superior Court of the State of California, County of San Francisco, Case No. 04-431105 (deposition testimony)

*In The Matter of Herring Broadcasting, Inc. d/b/a Wealth TV vs. Bright House Networks, LLC and Cox Communications, Inc.,*Federal Communications Commission, Washington, DC, File Nos. CSR-7709-P, 7822-P, 7829-P, 7907-P. (deposition testimony, FCC hearing testimony)

*In the matter of Rubber Chemicals Antitrust Litigation: Bridgestone Americas Holdings, Inc., et al v. Chemtura Corp., et al,* U.S. District Court, Northern District of California, Individual Case No. C 06-5700-MJJ (testimony in an arbitration hearing)

*International Business Machines* v. *T3 Technologies, Inc.,* U.S. District Court, Southern District of New York, Civ. Action No. 06-cv-13565-LAK (deposition testimony)

*In the matter of BP America Production Company v. Repsol YPF, S.A.,* Arbitration under the Uncitral Arbitration Rules (testimony in an arbitration hearing)

*Tessera Technologies, Inc. v. Hynix Semiconductor, Inc.,* Case No. 106CV-07668, Sup. Ct. of the State of California, County of Santa Clara (deposition testimony)

*In Re: TFT-LCD (Flat Panel) Antitrust Litigation,* U.S. Dist. Court, N.D. of California, No. M 07-1827 SI, MDL No. 1827

*Enron Coal Services Ltd. And English Welsh and Scottish Railway Ltd.*, In the Competition Appeal Tribunal (London, U.K.), Case No. 1106/5/7/08 (testimony in the Hearing)

*Geoffrey Pecover, et al* v. *Electronic Arts,* Case No. C08-02820VRW, US Dist. Court, N.D. of CA, San Francisco Div. (deposition testimony)

*Darren Berry, et al* v. *Volkswagen of America, Inc.,* Case No. 0516-CV01171-01, Cir. Court of Jackson County, Missouri at Independence (deposition testimony)

*Ekaterini Kotaras, et al* v. *Whole Foods Market,* U.S. Dist. Court, Dist. of Columbia, 1:08-cv-01832 - PLF

## Appendix Two

1. In this appendix, I illustrate with straightforward numerical examples the arms-length bargaining outcomes predicted by economic theory under two different scenarios: negotiations between a webcaster and individual record companies and, alternatively, negotiations between a webcasters and the record companies represented collectively by SoundExchange. I also present a model to demonstrate the more general result that the more licensors there are in the market, the lower will be the combined royalties charged by the companies under collective negotiations vis-à-vis individual negotiations.

2. Suppose that there are two symmetric record companies in the market, Company 1 and Company 2. Webcasters in this example are assumed to be perfectly competitive, and each webcaster must obtain a license from both Company 1 and Company 2 in order to operate an economically viable service. Let $R_1$ and $R_2$ denote the royalties charged by Company 1 and Company 2, respectively. For simplicity, assume that webcasters have no costs other than the royalties paid pursuant to their license agreements with the record companies. Webcasters sell to downstream consumers, whose total demand is given by the function $D = 12 - P$, where $D$ denotes total demand and $P$ denotes the price charged by webcasters.

3. First, assume that Company 1 and Company 2 negotiate their licenses collectively. Because webcasters are perfectly competitive, they fully pass the royalty costs to downstream consumers and therefore the price charged to downstream consumers is exactly equal to the sum of the royalties charged by the two firms, i.e., $P = R_1 + R_2$. The combined profit of the record companies is $(R_1 + R_2) * D$, or equivalently $(R_1 + R_2) * (12 - P)$, or equivalently $(R_1 + R_2) * (12 - (R_1 + R_2))$. The first order condition dictates that $(12 - 2 * (R_1 + R_2)) = 0$, and therefore the royalty that maximizes the combined profit is $(R_1 + R_2) = 6$. The market outcome is such that $P = (R_1 + R_2) = 6$, $D = 12 - P = 12 - 6 = 6$, and

the combined profit of the two companies is equal to $P * D = 6 * 6 = 36$. Consumer surplus is $(12 - 6) * 6/2 = 18$.

4. Now suppose that each company sets its royalty individually. Under this scenario, each company can only affect its own royalty while taking the royalty charged by the other company as given. Take the decision of Company 1. The profit of company 1 is given by $R_1 * D = R_1 * (12 - P) = R_1 * \big(12 - (R_1 + R_2)\big)$. Maximizing with respect to $R_1$, the first order condition faced by Company 1 is $12 - 2R_1 - R_2 = 0$, or $R_1 = \frac{12 - R_2}{2}$. Company 2 solves a symmetric problem, and therefore its first order condition is $R_2 = \frac{12 - R_1}{2}$. Solving for $R_1$ and $R_2$, it is easy to show that $R_1 = R_2 = 4$. The combined royalty charged by the two companies is $4 + 4 = 8$. Demand is given by $D = 12 - P = 12 - (R_1 + R_2) = 12 - 8 = 4$. Each company earns a profit equal to its royalty times the demand, or $4 * 4 = 16$. Consumer surplus in this case is $(12 - 8) * 4/2 = 8$.

5. Comparing the outcomes of these two scenarios, it is easy to see that when the two companies negotiate collectively, the combined royalties that they charge are lower, the market price is lower, market demand is higher, and therefore consumer surplus is also higher. This result is based on the intuition discussed in Section V: collective negotiations allow the two companies to internalize the negative effect that their royalties impose on market demand, resulting in lower royalties and lower market prices.

6. More generally, suppose that there are N symmetric record companies in the market, denoted Company 1, Company 2,..., Company N. Let $R_i$ denote the royalty charged by Company $i$, where $i = 1,2, \ldots, N$. As in the numerical example, Webcasters are perfectly competitive, and each webcaster must obtain a license from all record companies in order to operate an economically viable service. Webcasters sell to downstream consumers, whose total demand is given by the function $D = A - BP$, where $D$ denotes total demand, $P$ denotes the price charged by webcasters, and $A$ and $B$ are parameters.

7. Suppose that Companies 1,2,…, $N$ negotiate their licenses collectively. As before, the fact that webcasters are perfectly competitive implies that $P = R_1 + R_2 + \cdots + R_N$. The combined profit of the record companies is $P * D$, or equivalently $P * (A - BP)$. The first order condition dictates that $(A - BP) + P(-B) = 0$, and therefore $P = \frac{1}{2}\frac{A}{B}$.

8. Now suppose that each company sets its royalty individually. The profit of each company $i$ is given by $R_i * D$, or equivalently $R_i * (A - BP) = R_i * (A - B(R_i + P_{-i}))$ where $P_{-i}$ denotes the sum of the royalties of all the companies except for company $i$. As in the numerical example, each company takes $P_{-i}$ – i.e. the prices of the other companies – as given. Maximizing with respect to $R_i$, the first order condition faced by Company $i$ is $\big(A - B(R_i + P_{-i})\big) + R_i(-B) = 0$, which implies that $R_i = \frac{A - BP_{-i}}{2B}$. Since all the companies are symmetric, in equilibrium it is the case that $P_{-i} = (N-1)R_i$, and therefore $R_i = \frac{A - B(N-1)R_i}{2B}$, or $R_i = \frac{1}{N+1}\frac{A}{B}$. The sum of the prices of all the companies is equal to $P = N * R_i = \frac{N}{N+1}\frac{A}{B}$.

9. The market price under individual bargaining, $\frac{N}{N+1}\frac{A}{B}$, is always higher than the market price under collective bargaining, $\frac{1}{2}\frac{A}{B}$. This implies that under collective bargaining the quantity is higher and therefore consumer surplus is higher. Moreover, the difference between the two prices, $\frac{N}{N+1}\frac{A}{B} - \frac{1}{2}\frac{A}{B} = \frac{N-1}{2(N+1)}\frac{A}{B}$, is increasing in the number of firms $N$. Therefore, the more licensors there are in the market, the higher the combined royalties charged by the companies (and the lower the consumer surplus) under individual negotiations vis-à-vis collective negotiations.

**Before the**
**UNITED STATES COPYRIGHT ROYALTY JUDGES**
**Washington, D.C.**

| | |
|---|---|
| In the Matter of:<br><br>Digital Performance Right in Sound Recordings and Ephemeral Recordings | Docket No. 2009-1<br>CRB Webcasting III |

**WRITTEN REBUTTAL TESTIMONY OF**

# KYLE FUNN

**Manager, Licensing & Enforcement**
**SoundExchange, Inc.**

**June 2010**

# WRITTEN REBUTTAL TESTIMONY OF KYLE FUNN

## Background and Qualifications

I am Manager, Licensing and Enforcement, at SoundExchange. I have worked at SoundExchange since May 2005. I have held my current position since early 2008. I previously served as Licensing and Enforcement Specialist at SoundExchange. My current job responsibilities include monitoring licensees' compliance with the regulations related to payment and reports of use, and communicating deficiencies to them. I act as a liaison between SoundExchange and licensees related to their compliance with statutory and regulatory requirements. In monitoring licensees' compliance, I work both with SoundExchange's finance department, which receives and processes royalty payments and statements of account from licensees, and its distribution services department, which receives and processes reports of use. In addition, I field questions from current and prospective licensees regarding general licensing, reporting and payment issues.

## Discussion

I am submitting this rebuttal testimony to respond to Live365's proposal that it should receive a 20% aggregator discount from its proposed rates applicable to commercial webcasters. Live365 has proposed that "a streaming service that operates a network of at least one hundred (100) independently-operated 'aggregated webcasters'" should receive a 20% discount from the royalty rate set for commercial webcasting services. *See* Live365 Rate Proposal, Section I.B (Sept. 29, 2009). Live365 claims that it is entitled to this discount because of alleged "administrative savings" and other benefits it provides to copyright owners and SoundExchange. *See, e.g.*, Corrected and Amended Testimony of Mark R. Fratrik at 38-39.

In reality, however, Live365 has engaged in conduct that has created more work for SoundExchange, not less. As I understand the Court has already heard from other witnesses, after the Webcasting II decision, Live365 paid royalties at the incorrect royalty rate. In May 2008, we sent a letter to Live365 that notified Live365 that, among other things, it was failing to pay at the appropriate royalty rates. In April 2009 and August 2009, we contacted Live365 again because it still was not complying with the rates and terms set in the Webcasting II proceeding, and we repeated our demand that it pay in compliance with the regulations. Despite our repeated efforts, Live365 did not comply with the rates set in the Webcasting II proceeding until very recently.

Live365's decision not to pay royalties in compliance with the Webcasting II decision imposed a burden on SoundExchange. Over the course of approximately two years, SoundExchange had to spend time and money analyzing Live365's lack of compliance and repeatedly notifying Live365 about its failure to pay royalties at the correct rates. Moreover, because Live365 pays royalties to SoundExchange on behalf of thousands of webcasters, when Live365 was paying at the incorrect rates, it was causing thousands of webcasters to be out of compliance with the statutory license, even as those webcasters may have believed that they were compliant. And because Live365 has not provided SoundExchange with a list of the thousands of webcasters for whom it purports to pay SoundExchange, it can be more time-consuming for SoundExchange to determine whether a webcaster is complying with the statutory licenses.

Live365 also interfered with SoundExchange's collection and processing of information related to the webcasters for whom Live365 pays and reports to SoundExchange. In order to collect information in an efficient and uniform fashion from licensees, SoundExchange makes

template statement of account forms available on its web site. I am attaching the template 2009 statement of account for commercial webcasters as SoundExchange Rebuttal Exhibit 1 to my testimony. That template provides spaces for a webcaster to input the number of performances for each month, and then directs webcasters to multiply the number of performances by the applicable royalty rate for 2009 ($0.0018). The template statement of account form is designed to make it as easy as possible for webcasters to calculate the royalties they owe to SoundExchange. Most webcasters that pay SoundExchange use the template statement of account forms. Having the statement of account information in a standardized format makes it easier to review, and decreases the potential for errors due to human intervention and discretion. It is for this reason that SoundExchange is proposing in its revised rate proposal that webcasters be required to use the template statement of account form that SoundExchange makes available on its web site.[1]

If a webcaster does not use the standard statement of account form, it creates additional work for SoundExchange because the information that is submitted in a non-standard format cannot be processed as easily. Unfortunately, after the Webcasting II decision, Live365 did not use the correct statement of account template, and instead submitted statement of account forms that appear to have been doctored. For example, in December 2009, Live365 submitted the statement of account form that is attached hereto as SoundExchange Rebuttal Exhibit 2 (Restricted). The form that Live365 submitted appears designed to look like an official SoundExchange form, but it calculates royalties at incorrect royalty rates for the current rate period. It appears that Live365 took a statement of account form from the prior rate period and

[1] In connection with statement of account forms, SoundExchange is also proposing that licensees should be allowed to submit electronic signatures instead of handwritten signatures. The purpose of this proposal is to make it easier for licensees to submit statements of account.

altered it so that it purports to be a 2009 form. As you can see from looking at this exhibit, the form claims to be a "Statement of Account for Commercial Webcasters Per Performance 2009," and includes the SoundExchange logo and other information that make it look like a form issued by SoundExchange for 2009. But on the first page of the form, in the section where a webcaster calculates the royalties due, the form instructs a webcaster to multiply its total performances by "$0.000762," and it instructs the webcaster to take a 4% deduction on the total number of reported performances. That, of course, is the Webcasting I rate and was not applicable in 2009. By submitting doctored Statement of Account forms, Live365 interfered with SoundExchange's efforts to administer the statutory licenses as efficiently as possible. This deliberate non-compliance creates additional work for SoundExchange and undermines the claim that Live365 should receive a discount.

Finally, I should also note that Live365 and other services with 100 or more stations or channels already obtain a benefit from SoundExchange that is not available to other services. Under the final regulations adopted by the CRJs for 2006 - 2010 (37 C.F.R. § 380.3(b)(1)), and under the Stipulation (May 14, 2010) submitted by Live365 and SoundExchange in Webcasting III for 2011 - 2015, the $500 per station or channel minimum fee is capped at $50,000. Thus, a service such as Live365 that aggregates thousands of stations already receives a substantial benefit because it is required to pay only $50,000 in minimum fees as opposed to, for example, the $2.5 million it would have to pay in minimum fees if it paid minimum fees for 5,000 stations or channels.

I declare under penalty of perjury that the foregoing testimony is true and correct.

Date: 06/07/2010

Kyle Funn

E

# STATEMENT OF ACCOUNT FOR A COMMERCIAL WEBCASTER
## 2009 USAGE

Send payments and statements to:

SoundExchange, Inc.
1121 Fourteenth St., N.W., Suite 700
Washington, DC 20005
Attn: Royalty Administration

**Please refer to page 4 for instructions to filling out this form.**

| | | |
|---|---|---|
| 1 | For the 2009 month of: | |
| 2 | Name of service: | |
| 3 | URL: | |
| 4 | Station/channel name (e.g., call letters)*:<br>*If reporting more than one, list on page 3 | |

| | 2009 Month | Total Performances |
|---|---|---|
| 5 | January | |
| 6 | Feburary | |
| 7 | March | |
| 8 | April | |
| 9 | May | |
| 10 | June | |
| 11 | July | |
| 12 | August | |
| 13 | September | |
| 14 | October | |
| 15 | November | |
| 16 | December | |
| 17 | Sum of lines 5 - 16 above | 0 |
| 18 | Line 17 multiplied by $0.0018 | $ - |

| | | |
|---|---|---|
| 19 | Enter the total amount of stations/channels transmitting in 2009. | |
| 20 | Line 19 multiplied by $500. This is your total 2009 minimum fee liability. | $ - |
| 21 | The greater of (a) Line 18 or (b) Line 20. **This is the total current 2009 liability for the station(s) or channel(s) listed on Line 4.** | $ - |
| 22 | Enter amounts previously paid for 2009 liability (including both usage and minimum fee payments). | |
| 23 | Line 22 subtracted from Line 21. **This is the current amount that is due.** Payments are due within **45 days** of the end of each month, and **must** be accompanied by a statement of account form. | $ - |



(OFFICE USE ONLY - CRB 2006-2010)

**SX Rebuttal Ex. 1**

# STATEMENT OF ACCOUNT FOR A COMMERCIAL WEBCASTER
## 2009 USAGE
### CERTIFICATION PAGE

*I, the undersigned owner or agent of the Licensee, or officer or partner, if the Licensee is a corporation or partnership, have examined this Statement of Account and hereby certify that the information provided herein is true, accurate and complete to my knowledge after reasonable due diligence.*

[All of the below information is required by federal regulations. See 72 Fed. Reg. 24,084, (May 1, 2007) (37 C.F.R. § 380.4(f).]

Signature: _____

Name: _____

Title: _____

E-mail Address: _____

Address: _____

City, State, Zip: _____

Telephone Number: _____

Date: _____



(OFFICE USE ONLY - CRB 2006-2010)

# STATEMENT OF ACCOUNT FOR A COMMERCIAL WEBCASTER
## 2009 USAGE
### STATION/CHANNEL LIST

| | STATION/CHANNEL NAME (e.g., Call Letters) | URL | DATE OF INITIAL TRANSMISSION |
|---|---|---|---|
| 1 | | | |
| 2 | | | |
| 3 | | | |
| 4 | | | |
| 5 | | | |
| 6 | | | |
| 7 | | | |
| 8 | | | |
| 9 | | | |
| 10 | | | |
| 11 | | | |
| 12 | | | |
| 13 | | | |
| 14 | | | |
| 15 | | | |
| 16 | | | |
| 17 | | | |
| 18 | | | |
| 19 | | | |
| 20 | | | |
| 21 | | | |
| 22 | | | |
| 23 | | | |
| 24 | | | |
| 25 | | | |

(If the number of stations/channels exceed 25, please submit an accompanying list to accommodate.)

# STATEMENT OF ACCOUNT FOR A COMMERCIAL WEBCASTER
## 2009 USAGE
### INSTRUCTIONS

| | |
|---|---|
| 1 | Enter the month for the most recent usage reported on the statement of account. |
| 2 | Enter the "name of service" as listed on the Licensee's Notice of Use filed with the Copyright Office. If you have *not* submitted a Notice of Use form, please do so immediately. Notices of Use may be downloaded from either www.copyright.gov or www.soundexchange.com. |
| 3 | Enter the URL listed on the Licensee's Notice of Use. |
| 4 | Enter the applicable station or channel name. For example, if a station has "call letters," they would be entered here. If the statement of account reports the usage of multiple stations or channels, please list them accordingly on page 3. |
| 5-16 | For lines 5 through 16, enter the total amount of performances, year to date, for ALL months from January through, and including, the month indicated on Line 1. If there are any adjustments from previously submitted performances, services must complete and submit Worksheet A, available on our website (www.soundexchange.com). |
| 17 | Enter the sum of Lines 5 through 16. |
| 18 | Multiply Line 17 by $0.0018. This is the 2009 rate. |
| 19 | Enter the total number of stations or channels that are operating under statutory licensing in 2009. If this number includes stations or channels that were not included on previous submissions, please ensure that they are listed on page 3. |
| 20 | Multiply Line 19 by $500. This represents your total current minimum fee liability for 2009. |
| 21 | Enter the greater of your usage liability (Line 18) or your minimum fee liability (Line 20). This is the current total 2009 liability for the station or channel. |
| 22 | Enter any previous payments to SoundExchange for 2009 liability. This includes any prior minimum fee and/or usage payments. If the statement of account reports multiple stations or channels, please ensure that the previous payments correspond accordingly. Likewise, if the statement of account only represents a single station or channel, please ensure that other payments for other stations or channels or not represented. |
| 23 | Enter the amount of Line 22 subtracted from Line 21. This is the total amount that is due. Payments are due within 45 days of the end of each month, and must be accompanied by a statement of account form. |

(For more information regarding webcasting rates and terms, including definitions, please see 37 C.F.R. § 380.)

**NOTICE**

SoundExchange will **not** confirm receipt of payments or statements of account. If a service requires confirmation of receipt, please use registered mail, return receipt requested, or an express/overnight delivery service with tracking ability.

Services that have filed a Notice of Use of Sound Recordings under Statutory License with the Copyright Office are obligated to comply with all requirements of the statutory licenses under Sections 112 and 114 of the Copyright Act. It is the responsibility of each such service to ensure that it is in full compliance with the requirements of the statutory licenses under 17 U.S.C. §§ 112 & 114. SoundExchange is not in a position to determine whether each of the many services that rely on these statutory licenses is eligible for statutory licensing and does not in fact make any such determination. Nor does SoundExchange verify that such services are in full compliance with all applicable requirements of the two statutory licenses. Accordingly, SoundExchange's acceptance of a service's payment does not express or imply any acknowledgment that a service is in compliance with the requirements of the statutory licenses. SoundExchange, its members and other copyright owners reserve all their rights to take enforcement action against a service that is not in compliance with those requirements, regardless of any royalty payments such service may have made to SoundExchange.



(OFFICE USE ONLY - CRB 2006-2010)

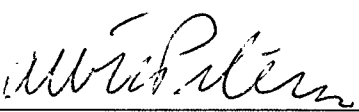
F

**This exhibit is Restricted under the Protective Order entered in this proceeding and is therefore omitted from the public version of this filing.**

**CERTIFICATE OF SERVICE**

I, Albert Peterson, do hereby certify that copies of the foregoing Written Rebuttal Statement of SoundExchange, Inc. (Public Version) were sent via overnight mail this 8th day of June, 2010 to the following:

| | |
|---|---|
| William Malone<br>James Hobson<br>Matthew K. Schettenhelm<br>MILLER & VAN EATON, PLLC<br>1155 Connecticut Avenue, NW, Suite 1000<br>Washington, DC 20036-4306<br>wmalone@millervaneaton.com<br>mschettenhelm@millervaneaton.com<br><br>*Counsel for Intercollegiate Broadcasting System, Inc.* | Angus M. MacDonald<br>Ara Hovanesian<br>Abraham Yacobian<br>HOVANESIAN & HOVANESIAN<br>301 E. Colorado Blvd., Ste. 514<br>Pasadena, CA 91101-1919<br>Fax: 626/795-8900<br>angusm@hovlaw.com<br>arah@hovlaw.com<br>abrahamy@hovlaw.com<br><br>*Counsel for LIVE365, Inc.* |
| David D. Oxenford<br>Adam S. Caldwell<br>Ronald G. London<br>DAVIS WRIGHT TREMAINE, LLP<br>1919 Pennsylvania Ave., NW, Suite 200<br>Washington, D.C. 20006<br>Fax: 202/793-4499<br>davidoxenford@dwt.com<br>adamcaldwell@dwt.com<br>ronaldlondon@dwt.com<br><br>*Counsel for LIVE365, Inc.* | William B. Colitre<br>ROYALTY LOGIC, LLC<br>21122 Erwin Street<br>Woodland Hills, CA 91367<br>Bcolitre@RoyaltyLogic.com<br>Fax: 818/558-3484 |
| Mitchell L. Stoltz<br>CONSTANTINE CANNON LLP<br>1301 K St. NW, Ste. 1050 East<br>Washington, D.C. 20005<br>Fax: 202/204-3501<br>mstoltz@constantinecannon.com<br><br>*Counsel for College Broadcasters, Inc.* | Catherine R. Gellis, Esq.<br>P.O. Box 2477<br>Sausalito, CA 94966<br>cbi@cathygellis.com<br><br>*Counsel for College Broadcasters, Inc.* |



Albert Peterson